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STUDY BY THE STAFF OF THE U.S.

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General Accounting Office

Domestic Housing And Community Development: Issues For Planning



As we enter the 1980s a decent, safe, and sanitary home and a suitable living environment for all Americans is a goal that is still far from being achieved. The increasing cost of constructing and operating housing continues to adversely affect our Nation's efforts in meeting housing needs. Likewise, the migration of people and jobs and the increasing cost of providing essential community services have placed many communities in a serious financial position. Whether these problems can be successfully resolved are major questions to be answered in the years ahead.

This study examines current and emerging issues relating to Federal involvement in the housing and community development area and represents the perspective used in organizing GAO audit efforts.



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Staff study

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FOREWORD

Rapidly increasing costs to buy, lease, or maintain housing and to provide essential community services will continue during the 1980s. Containing these costs is essential if the Nation is to make significant progress toward the goal of a decent, safe, and sanitary home and a suitable living environment for all Americans.

This study identifies and describes what we believe are the critical housing and community development issues facing the Nation. This study was originally prepared as an internal guide to focus our work in housing and community development. Our work will be directed to evaluations that address the

- effectiveness of the Nation's efforts to house lower income families,
- Federal efforts to preserve the physical and financial integrity of federally assisted housing,
- Federal efforts to control the high cost of homeownership,
- effectiveness of Federal efforts to provide mortgage credit and stabilize financing to maintain a viable housing industry,
- Federal efforts to preserve and improve the quality of life in urban and rural communities,
- Federal loans and grants to businesses for assisting community development,
- effectiveness of Federal efforts to assist economically distressed communities, and
- effectiveness of Federal programs in assisting communities to prepare for and recover from catastrophes.

We hope that others will find this study helpful and that it will foster a better understanding of the domestic housing and community development issues facing the Nation. This study was developed by the Community and Economic Development Division with the cooperation of and input from our other divisions and offices.

Questions regarding the study should be directed to
Ronnie E. Wood, Issue Area Planning Director, on 202/275-5475.

A handwritten signature in black ink that reads "Henry Eschwege". The signature is written in a cursive style with a large initial "H".

Director
Community and Economic
Development Division

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ABBREVIATIONS

CDBGs	Community Development Block Grants
EDA	Economic Development Administration
FmHA	Farmers Home Administration
FEMA	Federal Emergency Management Agency
FHLBB	Federal Home Loan Bank Board
FHLMC	Federal Home Loan Mortgage Corporation
FHA	Federal Housing Administration
FIA	Federal Insurance Administration
FLB	Federal land bank
FNMA	Federal National Mortgage Association
GNMA	Government National Mortgage Association
HUD	Department of Housing and Urban Development
SBA	Small Business Administration
UDAG	Urban Development Action Grant
VA	Veterans Administration

CHAPTER 1

OVERVIEW OF ISSUE AREA

Many serious housing and community development problems face our Nation during the 1980s. Housing costs have risen to the point where few American families can afford to buy a home. At the same time, the Nation is facing a severe shortage of rental housing with almost no private construction of rental housing for low- and moderate-income families. To compound these problems the number of households will increase 19 percent during the 1980s, placing greater demand on the housing supply.

Americans continue to migrate to the South and West and increasingly to rural areas. Population redistribution is responsible for a wide range of present urban problems such as the concentration of disadvantaged groups within central cities and rural problems such as inadequate public facilities and services. To cope with these problems the current administration established in 1978 a "National Urban Policy" and in 1979 a "Small Community and Rural Development Policy." How well these policies and available resources are able to address the many urban and rural problems will determine whether our Nation is making progress in achieving the goal of a decent home and a suitable living environment for every American family.

DELINEATION OF THE ISSUE AREA

The Domestic Housing and Community Development Issue Area encompasses two closely related subjects--housing and community development. For this study, housing includes:

- Federal programs and activities (mortgage insurance and guarantees; direct loans, grants, and cash subsidies; or other funding relating to (1) producing new homeownership and rental housing, (2) preserving existing homeownership and rental housing through repair work, substantial rehabilitation, or code enforcement action, (3) renting single-family or multifamily properties, (4) managing and operating federally subsidized housing properties, (5) managing single-family and multifamily properties acquired through mortgage defaults, (6) constructing, managing, and operating domestic military housing for military personnel and their families, and (7) housing provided by Federal agencies to employees and their dependents).
- Federally sponsored mortgage market activities of the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Government National Mortgage Association, and the Federal home loan banks.

Community development involves many Federal programs which in some way affect the community--the Catalog of Federal Domestic Assistance lists around 300. Our interest, however, deals with those programs which affect the community as a whole and its economic development. Our definition of community development therefore includes:

- Area and regional development programs.
- Federal efforts designed to make a community a more suitable place to live, including Federal programs and activities designed to
 - assist communities to preserve and improve the quality of life;
 - assist economically distressed communities;
 - encourage and foster economic development in communities through improved public facilities and through loans and grants to businesses, to the extent these activities' primary focus is on community development; and
 - minimize the adverse effects from catastrophes such as floods, hurricanes, and earthquakes.
- Evaluation of the significant impact on families, businesses, and communities from the termination, initiation, or major change in Federal installations or programs.

FEDERAL ROLE IN HOUSING AND COMMUNITY DEVELOPMENT

The Federal Government's role in housing and community development from 1932 to present is intricate and tangled. There are three broad areas of concern that have guided the Federal Government's participation in housing and community development. These include the recognition that it had (1) a responsibility to maintain and promote economic stability, (2) a social obligation to help provide for those in need, and (3) an emerging interest in how the Nation's communities developed.

Housing programs

In the 1930s the Congress made two fundamental policy decisions which basically remain intact to this day. The first was the complete restructuring of the private home financing system through the creation of the Federal Housing Administration (FHA) (mortgage insurance); the Federal Home Loan Bank Board and Bank System (savings and loan industry); institutions like the Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation (insurance on deposits

of commercial banks, mutual savings banks, and savings and loan associations); and finally the Federal National Mortgage Association (FNMA), the Government National Mortgage Association (GNMA), and the Federal Home Loan Mortgage Corporation (FHLMC) (secondary mortgage market). Creation of these institutions, resulting in the acceptability of the long-term, low downpayment, fully amortizing mortgage and a system to provide a large flow of capital into the mortgage market, is probably the most significant achievement of the Federal Government in the housing area.

The other fundamental policy decision in the same decade was the concept of Government-subsidized housing for low-income families. Although the public housing program authorized in 1937 was intended primarily as a means of stimulating employment and clearing slums, it nonetheless marked the first time that Federal funds were used to finance new housing construction for low-income families.

In the years that followed, numerous Federal housing and community development programs were added to the statute books spurred by the 1949 enactment of the national goal of "a decent home and a suitable living environment for every American family." A number of mortgage insurance programs conferring special benefits on such groups as veterans, farmers, the elderly, and those displaced by other Government programs were added. Those programs were, in turn, followed by new subsidized mortgage insurance and subsidized direct loan programs benefiting low-income families and the elderly.

The principal Federal sources of housing assistance are the

- Department of Housing and Urban Development (HUD);
- Farmers Home Administration (FmHA), Department of Agriculture;
- Bureau of Indian Affairs, Department of the Interior;
- Veterans Administration (VA);
- Department of Defense;
- Federal National Mortgage Corporation;
- Federal Home Loan Mortgage Corporation; and
- Federal home loan banks.

In 1981 the Federal Government will have outstanding insured or guaranteed housing mortgages and home loans totaling over \$250 billion. In fiscal year 1981 the cash outlay for subsidy payments under various HUD and FmHA subsidized housing programs will amount to \$7.5 billion.

There are a number of Federal agencies, including the Department of Defense, that provide housing for their personnel and dependents. Defense, for example, owns and maintains 376,000 family housing units, 101,000 bachelor officer units, and 1,000,000 enlisted personnel spaces.

Community development programs

The Government's concern over community growth and development and what the cumulative effects of growth patterns would be on the welfare of the Nation as a whole has been expressed many times and in many forms. Public housing originated in 1937 as an effort to clear slums. Then in 1949 the Congress authorized a major program apart from the public housing program to deal with slum clearance. Still later, starting in 1954 and continuing in the 1960s and early 1970s, the concern over community growth and development was steadily expanded to include ever-larger areas--first entire neighborhoods, then whole sections of cities, and finally entire cities and counties and preplanned new communities. These efforts were designed to assist cities to solve urban problems and to encourage them to develop more orderly, attractive, and livable communities.

The Housing and Community Development Act of 1974 significantly affected Federal involvement in community development and housing improvement by replacing programs characterized by narrow, rigid purposes with block grants. Block grants enable a community to initiate efforts addressed to its unique circumstances in order to eliminate slums and blight, conserve and expand the housing stock, increase public services, improve the use of the land, and achieve other desirable community and national growth objectives. One of the important objectives of the act is to reduce the concentrations of lower income persons in impacted areas.

In the area of economic development in communities, the Area Redevelopment Administration was established in 1961 to improve the basic infrastructure of rural areas and to provide incentives to businesses to locate in depressed rural areas. In 1965 the Economic Development Administration (EDA) assumed the responsibilities of the Area Redevelopment Administration and began to focus economic development to urban areas as well as rural areas.

EDA assistance includes grants for State and local planning, technical assistance to public and private organizations, and construction of public facilities. It also includes direct loans and guaranteed loans for public works and business development. For 1981 the President's budget provides EDA with \$769 million for its development financing activities and \$900 million to guarantee development loans.

In March 1978 the President released the broad principles and guidelines of his National Urban Policy. This policy attempts to address the many social and economic problems that have been created by urban changes and regional shifts of the last two decades--in particular, the dramatic population shifts south and westward and the center city decline of the 1970s. During August 1978 the President signed four urban policy

Executive orders. They established an urban policy impact analysis process, targeted Federal procurement to labor surplus areas, gave preference to urban areas in locating Federal facilities, and legitimized the interagency coordinating council which had been in operation.

In December 1979 the President announced his Small Community and Rural Development Policy. It is directed at creating a framework within the Federal Government for giving a higher priority to rural development issues, rather than on proposing specific new programs with additional funds.

The principal Federal sources of community development assistance are the

- Department of Housing and Urban Development;
- Economic Development Administration and the Office of Minority Business Enterprise, Department of Commerce;
- Federal Emergency Management Agency (FEMA);
- Small Business Administration (SBA);
- Farmers Home Administration and Rural Electrification Administration, Department of Agriculture; and
- Community Services Administration.

Federal outlays in 1981 for community and regional development activities will be about \$9 billion. An additional \$28 billion will support civil public works and construction whose primary purpose is to fulfill other national needs but also promotes community and regional development.

FUTURE TRENDS

Our future work will be directed to providing the Congress and the executive branch with information and advice on how the Federal Government can best cope with the many changes that will occur. Summarized below are the major trends that we believe will shape housing and community development issues in the future.

Housing

The 1980s are already being referred to by many housing experts as "the decade of the housing crisis." Homeownership cost increases have priced 93 percent of American families out of being able to purchase a home. At the same time, the Nation's existing rental housing stock has reached its lowest vacancy rate with little prospect for any new, privately financed construction.

The World War II baby boom generation is now stepping forward to purchase their own homes. During the 1980s the age group of 25- to 64-year-olds will increase substantially. By 1989 the 25- to 34-year-olds will gain over 5 million persons (a 14-percent increase) and the 35- to 64-year-olds will increase about 12 million persons (16 percent). Since the majority of the homebuyers are within these two age groups, the housing demand for single-family homes will increase. An estimated 2 million new housing units each year are needed to meet the population increase.

Current trends in consumer preference by housing type began in the late 1970s and will continue into the 1980s due primarily to two factors--energy costs and the shift to an investment versus a shelter society. Because of the increasing energy costs, coupled with smaller family size, more consumers will be searching for smaller, more energy-efficient homes. Concurrently a number of second- and third-time buyers will be seeking larger homes. Their primary concern is a sound financial investment rather than just shelter.

The cost of heating and cooling buildings in an age of increased energy prices should encourage high-rise construction over townhouses and single-family detached houses, at least up to a point. Test results have shown increased thermal efficiency in buildings up to 10 stories, compared to single-family detached houses. As buildings become taller (50 or more stories), the increased energy necessary for general services (such as elevators) overcomes energy cost savings.

Traditional single-family home mortgages have been long-term with fixed interest rates and equal monthly payments. These worked satisfactorily until about the late 1960s when the United States started experiencing high inflation rates and slow real growth in personal incomes. With interest rates at an all time high, a movement has developed to try another approach--flexible mortgage instruments. Some experts believe we are now in a transition period which will be followed by the demise of fixed interest rate mortgages and the establishment of the flexible mortgage instrument industrywide. The major types of new mortgage instruments are the graduated payment mortgage, the variable rate mortgage, and the renegotiated rate mortgage.

Federal housing programs during the 1980s must deal with:

- The need for over 2 million new housing starts each year to meet our growing and mobile population and our changing lifestyles.
- The need to slow down the rapid increases in the cost to construct, operate, and finance housing.

--The increased need to provide housing for lower income persons. Housing deprivation is changing from a problem of physical inadequacies to that of excessive cost.

--The need to preserve our existing housing stock because it is unlikely the construction industry can meet our future housing needs through new construction.

Some recurring housing policy issues facing the Congress include:

--What level of funding should be provided for housing assistance programs and how should they be financed?

--What should be the mix of new construction, rehabilitation, and existing housing assistance?

--What kind of housing assistance should be provided to lower income homeowners, and should direct assistance be extended to higher income families?

--What mix of programs is most effective in encouraging housing production and providing countercyclical aid to the homebuilding industry?

--How should housing assistance programs be used to encourage community development?

Community development

Population redistribution is one of the most important forces affecting community development. In a mobile society like America, it is not surprising that 3 out of every 10 adult Americans say that they will move to a new residence in the next few years. The clear population losers in this relocation process are America's large cities. If the potential for migration is realized, the flow out of the city into suburban and rural areas will continue.

America is thinning out with greater population increases in the South and West and increasingly to rural areas. There is no single reason for this thinning-out process. Americans are more mobile today than in the past. People seek better climates and better environments. New technology, interstate highways, modern airports, and improved communications make it possible for business and industry to locate in the open spaces of undeveloped or less-developed areas.

Relative resource scarcity is replacing resource abundance as a dominant factor in the American economy. One implication of this trend on communities is that as growing scarcities drive up the cost of resources needed to develop new communities, the value of much of the existing capital stock in cities will increase.

Energy price increases should lead toward more compact, less sprawling settlements. As the cost of transportation rises, we should begin to observe a movement toward increased proximity of dwelling, working, shopping, and leisure time places as a reaction against the increased cost of traveling between these locations under today's relatively spreadout arrangements. Another effect of the energy crisis could be the encouragement of the existing movement toward smaller cities. Since longer trips are necessary in large metropolitan areas, cost savings could be realized by moving to a smaller city.

Urban communities will continue to be confronted with the need to satisfy rapidly growing expenditure requirements arising from the higher percentage of remaining "high cost" citizens--the poor and the elderly. On the other hand, their tax resources are either declining or are increasing at a decreasing rate, reflecting the exodus of industry and middle- and high-income families to the suburbs or rural areas.

Despite population and employment increases in rural areas, many rural and smalltown residents suffer from problems that afflict the poor wherever they live. Problems facing rural communities include

- 60 percent of America's substandard housing;
- inadequate services such as police, fire, public transportation, and health;
- lack of credit for housing, investment capital, and public facilities; and
- inadequate water and sewage systems.

The basic continuing community development problems facing the Nation include:

- The need to provide immediate assistance to the most troubled cities and communities. This should be targeted to help cities restructure their economies and better adapt to change.
- The need to help all cities offer their residents decent services, adequate jobs, sound neighborhoods, good housing, and healthy environments.
- The need to minimize community losses due to catastrophes.
- The presence of disorderly, uneconomic, and anti-social patterns of development and land use in the Nation.

- The increase in fiscal and political fragmentation resulting in an aggravating mismatch of needs and resources.
- The lag in development of community facilities in rural areas and areas experiencing rapid growth.
- Citizen alienation and/or apathy in the face of ineffective governmental action.

LEGISLATION AFFECTING
ISSUE AREA

In each session of the Congress hundreds of bills are introduced that could affect the housing and community development area. Each year many of the individual housing bills are consolidated to form comprehensive legislation amending various housing acts. Amendments and reauthorizations for EDA, FmHA, HUD, and SBA account for the major legislative changes affecting housing and community development.

Appendix I lists the major congressional committees concerned with housing and community development.

CHAPTER 2

IDENTIFYING AREAS OF

CONCERN AND LINES OF EFFORT

We have identified 28 lines of effort under eight areas of concern that merit our attention over the next 18 months. The areas of concern identify the universe for our work under the Domestic Housing and Community Development Issue Area. The lines of effort, of which 15 are designated priority, further delineate the areas of concern.

A. EFFECTIVENESS OF THE NATION'S EFFORTS TO HOUSE LOWER INCOME FAMILIES

Priority lines of effort

1. How efficiently and economically are present housing production programs being administered?
2. Are national strategies for housing lower income families sound?

Nonpriority line of effort

1. How effective are present Federal housing programs in serving the needs of lower income households?

B. FEDERAL EFFORTS TO PRESERVE THE PHYSICAL AND FINANCIAL INTEGRITY OF FEDERALLY ASSISTED HOUSING

Priority lines of effort

1. How can operating costs be controlled in federally assisted multifamily housing?
2. How can the Federal Government more effectively acquire, manage, and dispose of multifamily projects?

Nonpriority line of effort

1. How effective are Federal efforts in keeping multifamily housing in a standard condition?

C. IMPROVING FEDERAL EFFORTS TO CONTROL THE
HIGH COST OF HOMEOWNERSHIP

Priority lines of effort

1. How effective are Federal efforts to implement and encourage coordinated national policies and local regulatory efforts aimed at constraining housing costs?
2. How effective are the Federal Government's efforts to encourage the housing industry to develop and use cost-controlling measures?

D. EFFECTIVENESS OF FEDERAL EFFORTS TO PROVIDE
MORTGAGE CREDIT AND STABILIZE FINANCING TO
MAINTAIN A VIABLE HOUSING INDUSTRY

Priority line of effort

1. Are Federal efforts effective in providing mortgage credit at reasonable costs?

Nonpriority lines of effort

1. Are Federal efforts aimed at moderating cyclical instability in the housing industry efficient and effective?
2. What needs to be done to make mortgage financing available in all locations and for low-income families at reasonable costs?
3. Are Federal housing credit agencies organized in an efficient and effective manner?

E. STRENGTHENING FEDERAL EFFORTS TO PRESERVE
AND IMPROVE THE QUALITY OF LIFE IN URBAN
AND RURAL COMMUNITIES

Priority lines of effort

1. How efficient and economical are Federal efforts to preserve and revitalize urban communities?
2. How effective is the Nation's comprehensive rural development policy?

Nonpriority lines of effort

1. How effective and coordinated are Federal efforts to provide essential facilities and services to rural communities?

2. How effective are local communities in administering community development activities?

F. ASSISTING COMMUNITY DEVELOPMENT THROUGH
LOANS AND GRANTS TO BUSINESSES

Priority lines of effort

1. How efficient and effective are Federal programs designed to develop viable firms owned by minority and other special groups?
2. Are agency financial assistance activities meeting the needs of the business community?
3. Have Federal management services and technical assistance helped small businesses overcome problems?
4. How effective are Federal loan programs for farmers?

Nonpriority line of effort

1. Are the problems of small businesses adequately addressed by the Federal Government?

G. EFFECTIVENESS OF FEDERAL EFFORTS TO ASSIST
ECONOMICALLY DISTRESSED COMMUNITIES

Priority line of effort

1. How effective and economical are Federal efforts in helping stimulate economic growth in distressed communities?

Nonpriority lines of effort

1. How effective are Federal efforts designed to help distressed communities develop comprehensive plans?
2. How effective are Federal efforts to target community development assistance to economically distressed urban areas?
3. Are economic problems of rural communities being adequately addressed by the Government?

H. EFFECTIVENESS OF FEDERAL PROGRAMS IN
ASSISTING COMMUNITIES TO PREPARE FOR AND
RECOVER FROM CATASTROPHES

Priority line of effort

1. How effective are Federal programs in assisting communities to respond to and recover from catastrophes?

Nonpriority lines of effort

1. How effective are FEMA's programs in minimizing adverse effects of catastrophes?
2. Is the Federal Government organized to deal effectively with catastrophes?

Areas of concern and lines of effort are described in more detail in chapters 3 through 10.

CHAPTER 3

EFFECTIVENESS OF THE NATION'S EFFORTS

TO HOUSE LOWER INCOME FAMILIES

The Housing Act of 1949 set a national goal of a decent home and suitable living environment for every American family. Attaining that goal has been elusive even though many Government-subsidized housing programs for lower income families ^{1/} have been established since 1937. The Federal Government will spend over \$250 billion over the next 40 years for subsidized housing provided through 1980.

Early in the 1970s, concern about the subsidized housing programs began to emerge. Homes in certain parts of the country were being abandoned, and overproduction of homes was apparent elsewhere. The cost of constructing units under certain programs came under attack as did the fact that the programs were able to serve only a fraction of the total number of households in need. In addition, the programs were criticized from the standpoint that they intensified the problems they were intended to solve by concentrating the poor in housing projects and burdening them with the stigma of being wards of the Government.

In response to these problems, many of the federally assisted housing programs were suspended by the Nixon administration in 1973. Since then there has been some shift in emphasis from production-oriented programs to programs that make recipients a part of the general market by providing funds or other means to compete for housing in neighborhoods of their choice. The major program coming from this redirection is the Section 8 Lower Income Rental Assistance Program authorized by the Housing and Community Development Act of 1974. This program benefits primarily urban areas and is used in tandem with several other programs which withstood the 1973 suspension. To improve the quality of life in rural America, the Farmers Home Administration's Section 502 Program makes available direct loans with reduced interest rates to lower income families seeking suitable housing. This program is a large one in which FmHA is planning to spend \$3 billion in fiscal year 1980.

Some controversy has existed concerning the extent to which each of HUD's subsidized housing programs should be used to meet the Federal commitment of assisting lower income families in obtaining housing. While some have favored using

^{1/}Generally refers to families with incomes of less than 80 percent of an area's median income.

the section 8 leased housing method almost exclusively, others have preferred continued use of the older construction-oriented programs as well as the Section 8 Program. Another problem which is emerging is the high cost of providing housing assistance to the poor. Under the Section 8 Program, for example, fair market rents and the corresponding housing subsidies have risen at significant rates over the life of the program to the point where average annual costs per unit in fiscal year 1981 are estimated to be as high as \$3,000 for existing units, \$4,200 for moderate rehabilitation, \$5,450 for new construction, and \$6,260 for substantial rehabilitation. Because the direct cost of existing housing is less, some favor more extensive use of this portion of the Section 8 Program to the detriment of the new construction and substantial rehabilitation portions. In February 1980 the unit mix for fiscal year 1981 was expected to be about 60 percent for new construction and substantial rehabilitation and about 40 percent for existing housing, including moderate rehabilitation.

In fiscal year 1980 the Federal Government will spend over \$5.5 billion to liquidate obligations previously made on various subsidized housing programs. Budget estimates for fiscal year 1981 show approximately \$1.5 billion as being needed to produce additional assisted housing during the year. This level of spending will support 258,000 section 8 units, 38,000 public housing units, and 4,000 units to be built on Indian reservations.

OBJECTIVES

Our objective under this area is to alert the Congress and Federal agencies to opportunities for

- improving Federal efforts to assist lower income households in occupying housing that is decent, safe, and sanitary and
- producing federally assisted housing more efficiently and economically.

PRIORITY LINE OF EFFORT

How Efficiently and Economically Are Present Housing Production Programs Being Administered?

With the broad range of economic problems our Nation now faces, such as the serious problem of inflation and substantial cost increases in goods and services, it becomes increasingly clear that the Federal Government must take drastic measures to eliminate nonessential spending in the production of our Nation's housing programs. The growth of domestic housing programs has taken place in largely unplanned, piecemeal fashion. This has resulted in too many overlapping programs, lack of coordination, and inequities. The direct and indirect

costs to the Federal Government to manage and operate these programs have grown to the point where the costs involved cannot be readily determined.

Housing production programs are plagued by inefficient management and charges that the cost to the Federal Government for many programs is more than it would cost the private sector to produce and provide similar housing services. Various congressional reports have stated that some of the less needy now receive a disproportionate share of Federal housing benefits, while some who are more needy receive less. To function efficiently, housing programs must bring together private builders, lenders, housing sponsors, purchasers, and public agencies.

We believe that this line of effort deserves priority attention because the Federal Government is the largest single entity involved in providing housing to the poor. Its programs are numerous, involving billions of dollars annually. Inflation continues to push costs up to the point where it has become very costly to provide housing. Some housing programs are more costly than others and need to be considered from the standpoint of their benefits versus their cost.

Our objective will be to provide answers to the following questions:

1. How can the costs of producing subsidized housing be reduced?
2. How can obstacles to producing subsidized housing be minimized?
3. Are subsidized housing benefits worth their costs?
4. Why does it cost the Federal Government more to produce housing than it does the private sector?

Ongoing assignments--August 1980

- Federal efforts to house handicapped persons (CED 382180) (addresses question 2).
- Cost to construct and operate section 8 housing for lower income persons (CED 382270) (addresses questions 1 and 4).
- Review of life cycle costs of section 8 partially assisted projects (CED 382280) (addresses question 1).
- Evaluation of the effectiveness of HUD and FmHA practices in selecting developers for constructing subsidized housing projects (CED 382290) (addresses question 1).

Our previous work in the subsidized housing area has been directed at program effectiveness and has provided bases for various agency actions. This work identified possible cost savings through changes in the administration of both the Public Housing and Section 8 Programs. Our strategy in conducting future assignments is to encourage agency action to produce assisted housing more efficiently and economically. We expect this action to provide the (1) basis for reducing costs by identifying costly program features and production obstacles and (2) Congress with better oversight of costs and benefits.

PRIORITY LINE OF EFFORT

Are National Strategies for Housing
Lower Income Families Sound?

Housing laws today represent an accumulation of authorizations for some 46 unsubsidized and 20 subsidized programs. In managing these programs, there exist inconsistencies, duplications, lack of coordination, abuses, and inadequate monitoring of program activities.

From modest beginnings 40 years ago, the presence and influence of the Federal Government has grown dramatically. Numerous Federal housing and housing-related programs have been added to the statute books. The number and complexity of programs at times acts as a deterrent to effective participation by builders and lenders and hinders effective management of individual programs.

The Congress has declared many housing policies. Some of the more important of these housing policies are listed below.

- There should be housing production and related community development sufficient to remedy the serious housing shortage and eliminate substandard housing.
- There should be as soon as feasible the realization of the goal of a decent home and a suitable living environment for every American family.
- Housing production is necessary to enable the housing industry to make its full contribution toward an economy of maximum employment, production, and purchasing power.

Housing programs and policies have evolved over the years to a point where they are being used as a strategy to meet other national interests, such as supplementing welfare programs and stabilizing the economy in periods of economic recession. A wide range of strategies can be used in meeting these goals, such as direct subsidies, loans, insurance, tax policies, or liberalizing credit terms. Priorities can be placed on types of units such as single-family or multifamily; existing versus new construction; and segments of society such as moderate income, lower income, veterans, the elderly, Indians, or rural families.

The Federal Government makes basic determinations of key program elements, such as the definition of the eligible family unit, income limits, and fair market rents. Also the overall amount of housing subsidies made available is controlled at the Federal level. The local role involves aspects of planning within the framework of the Federal budget and regulations, and in actually implementing or administering housing programs.

Our objective in assessing the decisionmaking process in the housing area is to provide answers to the following questions:

1. How effectively do the strategies for existing housing programs mesh, overlap, and complement each other in meeting national goals?
2. How can the governmental framework for housing policy decisionmaking be improved?
3. Is the current data base and data collection system adequate to provide the information necessary for planning and implementing policy?
4. Do today's subsidized housing policies adequately recognize both needs and constraints?

Ongoing assignments--August 1980

--Computerization of subsidized housing life cycle cost model (CED 387100) (addresses question 2).

Our previous work in this subject area primarily centered around our assessment of the decisionmaking process used to develop HUD's troubled-projects strategy. In the next 18 months, our strategy in conducting assignments is to critique the Federal agencies' ability to implement existing housing strategies, encourage the streamlining of such strategies, and anticipate changes in the housing environment. We expect this critique to provide the Congress and executive decision-makers with a better insight into the impact of and limitations inherent in existing housing strategies and an early assessment of options available to meet housing trends.

NONPRIORITY LINE OF EFFORT

How Effective Are Present Federal Programs in Serving the Needs of Lower Income Households?

Many Americans do not have the financial means to obtain suitable housing. HUD estimated recently that there were 18 million families in this country needing some form of housing assistance. Six million of these families are presently living in housing considered to be substandard, 10 million are spending a disproportionate share of their incomes for housing, and the remaining 2 million are living in overcrowded housing.

To assess how effectively current Federal housing programs are serving the needs of lower income persons, the following questions should be addressed:

1. Should policies be established to accelerate the rehabilitation of existing housing?
2. Is the number of American families too poor to afford the market price for adequate housing increasing or decreasing?
3. When does a family need a subsidy?
4. How can the Federal capacity to identify housing needs and program its limited resources be improved?

Current assignments

--Assessment of the Federal role in ensuring the purchase of quality housing (CED 382200) (addresses question 4).

OUR AUDIT REPORTS

Deconcentration of Persons in the Section 8 Leased Housing Program (CED-78-181, 10/20/78).

HUD's Processing of a Section 8 Project in Milford, Ohio (CED-79-7, 1/10/79 and CED-79-76, 4/25/79).

Cost of Section 8 Housing Could Increase If Owners Sell or Convert Projects Early (PAD-79-43, 1/16/79).

The College Housing Loan Program: More Effective Management Needed (CED-80-75, 3/26/80).

Ways a More Equitable Share of Federal Housing Support Can Be Provided to Rural Areas (CED-80-1, 3/28/80).

Section 8 Subsidized Housing: Some Observations
on Its High Rents, Costs, and Inequities (CED-80-59,
6/6/80).

Inquiry into FmHA's Selection of a Developer To
Construct a Housing Project in New Hampshire
(CED-80-119, 8/12/80).

CHAPTER 4

FEDERAL EFFORTS TO PRESERVE THE PHYSICAL

AND FINANCIAL INTEGRITY OF FEDERALLY

ASSISTED HOUSING

Since 1934 the Federal Government has sponsored insurance, grant, and subsidy programs that produced about 1.2 million units of public housing and about 16,400 multifamily housing projects with about 1.8 million units. This production represents (1) both a significant accomplishment and a significant investment in resources and (2) the Government's attempt to reach a national goal, set in the Housing Act of 1949, of a decent home and suitable living environment for every American family.

It is important that each federally assisted, multifamily rental housing unit or project be maintained in a decent, safe, and sanitary manner; that they possess desirable quality of life attributes; that they be managed economically and efficiently; that they serve those for whom they were intended; and that the insurance or subsidy funds are protected from loss caused by poor management.

Because the Government's multifamily housing programs were based upon a fixed amount which reduced the mortgage interest rate, the projects were particularly vulnerable to increasing maintenance, utility, and other operating costs and taxes. The drastic rise in these costs and taxes was caused, in part, by the high rates of inflation experienced in recent years. Owners, HUD, and FmHA believed that incomes would rise at the same rate as costs and therefore the project's financial integrity would be sustained over the years. Rent increases were granted to meet rising operating costs and taxes which in many instances eventually far outstripped increases in tenants' income and their corresponding ability to meet the increased costs. Consequently, any solution which involved substantial rent increases would displace the majority of these families and would defeat the original purpose of constructing the projects.

Because these projects were located in areas that attracted the working poor, the displaced family was replaced by a family in the same income level. The same scenario of rising costs outstripping tenants' ability to pay was repeated. While this scenario was occurring, project owners were protected by certain Federal investment tax advantages that worked in their favor, particularly in projects operating at a loss. With this protection, owners were less concerned with containing costs and thereby assuring the financial integrity of the project. It was only when sufficient cash was not available to make the mortgage payments that mortgagees became concerned.

This concern usually resulted in mortgage foreclosures or assignments of the mortgage to HUD. The result of this lack of aggressive action to contain costs and thereby protect the financial integrity of the project was that 2,032 projects failed financially during the 1970s, requiring the Government to pay \$3.7 billion in mortgage insurance claims. This inventory is expected to rise to 3,000 projects (342,000 units) by 1982 with claims totaling about \$5 billion.

In the past HUD's and FmHA's main objectives were to sell these properties as quickly as possible to ensure a maximum dollar return on the investment. Because of inadequate accounting systems, HUD was unable to identify which projects were operating at a loss. HUD's general and special mortgage insurance funds absorbed all operating losses of acquired or assigned projects. Consequently, little or no effort was made to control costs and thereby preserve the financial integrity of the projects. Projects were sold at sizable losses and insured with the same operating cost conditions (in some cases exacerbated by HUD's practices) to new owners whose main objective was the tax advantages accruing to such an investment. When the tax advantages were no longer in the owners' favor, the projects were allowed to fail financially and mortgagees again only became concerned when the projects finally failed.

If these conditions were allowed to continue, housing officials predicted that 5,960 subsidized, multifamily housing projects which HUD insured would fail financially before 1983. To help guard against this situation, the Congress authorized, in the Housing and Community Development Amendments of 1978, an appropriation of \$74 million in subsidies, known as the Troubled Project Strategy, to help 2,785 of the 5,960 projects.

An additional \$82 million was authorized in the 1979 amendments. The projects could possibly receive the subsidy for an unlimited period of time. However, the projects are supposed to eventually become financially self-sustaining. Recent information indicates that the subsidy will help overcome the incremental rises in costs during the 3 years the subsidy will be granted. However, owners are not aggressively pursuing long-term cost containment programs that would help preserve the financial integrity of the projects. In fact, the more costs rise in a project, the more the subsidy rises. If this inventory of multifamily projects is to remain part of the Nation's housing stock, owners, HUD, and FmHA must take a more aggressive role in preserving the financial integrity of these projects.

As the financial integrity of a project starts to pass through the stages of default, assignment, and ultimately foreclosure, the physical integrity also deteriorates. By the time either HUD or FmHA actually owns them, most projects are often a blight on the neighborhood and require extensive repair.

Housing officials nationwide have struggled with the problem of physical deterioration caused by rising expenses, inadequate funds for improvements, tenants' social problems, and poor management by local housing agencies and project owners. Contributing to this situation was the Government's belief that it was not responsible for the physical integrity of this housing after it was built. The Government perceived its role as passive: to pay an insurance claim, foreclose on the mortgage, and dispose of the property. This attitude crippled any effort to deal with problems once they occurred.

In May 1978 a HUD task force reported that about half of the 6,700 previously insured, subsidized, multifamily rental housing projects had deteriorated to such a low ebb that HUD was gaining the reputation of being known as "the Nation's largest slumlord." Recent testimony before the Senate Appropriations Committee in January 1980 by legal associations representing tenants in federally assisted multifamily rental projects again highlighted severe maintenance problems and physical decay of the quality of life in the projects. Lack of owner, project manager, and Federal agency concern was given as the cause.

The Government has assisted through insurance, grant, and subsidy programs the construction of about 3 million housing units. Once this production was accomplished, owners, mortgagees, HUD, and FmHA took a passive role concerning the financial and physical integrity of the housing. Tax advantages became the owners' goal. Quickly foreclosing or assigning the mortgage to HUD was the mortgagees' goal. "Dumping" the acquired properties to minimize losses was HUD's and FmHA's goal. All felt that somehow these separate and diverse goals were a manifestation of the Nation's housing goal when in fact they worked to erode the financial and physical integrity of the housing inventory. It is important therefore that owners, mortgagees, tenants, HUD, FmHA, and State and local agencies now coordinate their efforts and programs toward preserving the financial and physical integrity of multifamily projects. Otherwise the Nation will be further away from its goal of providing a decent home and suitable living environment for every family.

Our overall objectives of this area of concern are

- to get owners, tenants, and the responsible Federal agencies to work toward containing operating costs without jeopardizing the physical integrity of the housing units;
- to evaluate whether the livability of multifamily rental housing is adequately emphasized and coordinated in Federal programs; and

--to identify ways to improve the methods of managing and disposing of Government-owned housing while assuring the physical and financial integrity of the projects.

During this programing period, two priority lines of effort will be addressed, and broad reviews will be undertaken to identify issues, problems, and possible solutions to preserve the financial and physical integrity of multifamily housing projects.

PRIORITY LINE OF EFFORT

How Can Operating Costs Be Controlled in Federally Assisted, Multifamily Housing?

With the broad range of economic problems facing our Nation, such as the growing rate of inflation and the corresponding cost increases in goods and services that are seriously affecting the cost to operate federally assisted, multifamily projects, it becomes increasingly clear that to preserve this housing as a viable inventory, owners, tenants, and the Federal Government must now work together to control operating cost and eliminate nonessential spending. HUD has requested an increase in budget authority for fiscal year 1981 of \$2.5 billion to help overcome rising operating costs in its 3 million subsidized housing units. Consequently, controlling operating costs could result in significant savings in the Federal budget. However, controlling costs as a goal in itself or as a goal just to reduce budget amounts must be guarded against if it reduces or eliminates activities needed to preserve the physical integrity of the housing projects.

Our objectives will be to provide answers to the following questions:

1. What waste and inefficiency can be eliminated in operating multifamily housing?
2. Can costs to operate multifamily housing be reduced by adopting different cost-controlling methods?
3. How can effective cost-controlling methods be incorporated into existing and new multifamily housing programs?
4. How effectively do the Federal, State, and local governments work together to keep housing projects viable?

Ongoing assignments-August 1980

--Analysis of costs associated with operating multifamily projects (CED 383220) (addresses questions 1, 2, and 3).

--Analysis of the costs of operating and maintaining military family housing (CED 383221) (addresses questions 1 and 2).

Our previous work has identified ways to generate additional revenue in multifamily projects. Our strategy in future assignments will focus on identifying the elements of costs that can be controlled, evaluating alternative methods to control costs, finding ways to lessen the impact operating costs have on low-income tenants, and incorporating the strategy obtained from our work into existing or new Federal programs.

The results of our work should increase congressional awareness of the need for owners, tenants, and the responsible Federal agencies to contain operating costs in multifamily projects and to lessen the impact rising operating costs have on low-income tenants. Also these assignments should provide the Federal agencies alternative strategies that could eliminate wasteful and inefficient operating practices, effectively control operating costs, and preserve the financial integrity of this Nation's multifamily housing stock.

PRIORITY LINE OF EFFORT

How Can the Federal Government More Effectively Acquire, Manage, and Dispose of Multifamily Projects?

HUD and FmHA face a continuing problem of acquiring, managing, and disposing of multifamily projects that have failed financially. Currently, these agencies manage

- 283 acquired properties,
- 766 assigned mortgages, and
- 212 projects in serious financial difficulty.

An estimated 154,000 families live in these projects, which often are the only safe and relatively sanitary housing available in their neighborhoods.

Recent studies show that foreclosures of multifamily mortgages take an average of 2-1/2 years to accomplish. Extended proceedings in initiating foreclosures and obtaining control of projects result in increased losses to the Federal Government and may result in hardships on tenants because projects often deteriorate after mortgagors become aware of a potential foreclosure action. Reducing the time required for foreclosures is a key to controlling cost.

During fiscal year 1979, 99 multifamily housing mortgages were acquired. Based on readily available data for 54 of these mortgages, the average time from the date foreclosure action began until the foreclosure was actually accomplished was 31 months. The range was from 4 to 59 months. One reason owners often contest foreclosure actions is to extend the period of time in which they can benefit from accrued interest and depreciation deductions on the Federal income tax returns.

By virtue of ownership or assignment, the Federal agencies are charged with preserving and protecting the Government's interest in all property owned or assigned to it. HUD, in particular, has been criticized in its management of its acquired properties. In 1977 HUD spent about \$19 million more than it received in rental income to operate acquired projects.

In 1977 HUD made a major change in the way it disposed of acquired, formerly subsidized multifamily housing projects. Basically, the objective of HUD's new policy is to sell these projects in a manner which will keep them available to and affordable by low- and moderate-income families. HUD plans to meet its objective by selling these projects with commitments of section 8 subsidies attached to the sales.

It may cost HUD about \$1 billion in section 8 funds over the 15-year commitment period to dispose of its inventory (as of April 30, 1979) of 283 projects. If HUD acquires and subsequently disposes of the other 766 subsidized projects, which are either in foreclosure or in serious financial difficulty, an additional \$3.7 billion in section 8 commitments may be needed to sell these projects. On the basis of annual increases already experienced during the last 3 years on section 8 projects, the funds needed for the last year of the contract period could be more than double the amount budgeted under existing contracts; thus, the above estimates may be conservative.

Our objective is to provide answers to the following questions:

1. How effective and timely is the Federal Government in foreclosing on defaulted mortgages?
2. How can the Federal Government be more effective and economical in operating acquired properties?
3. How can Federal costs to dispose of properties be reduced?

Ongoing assignments-August 1980

- Evaluation of HUD and VA insurance benefits paid to mortgagees after foreclosure (CED 385080) (addresses question 2).

--Assessment of the effectiveness of HUD's corrective action on recommendations contained in previous GAO report, CED-79-67, April 12, 1979 (CED 385081) (addresses question 2).

--Effectiveness of the use of subsidies to sell acquired multifamily projects (CED 385082) (addresses question 3).

Most of our previous work has been related to the efficient and economical operation of acquired properties. The strategy for future assignments is to (1) critique HUD's and FmHA's ability to effectively and timely foreclose on defaulted multifamily housing mortgages and (2) identify alternative ways acquired properties can be sold which would preserve the financial and physical integrity of the housing and reduce the cost to operate and sell acquired properties. We expect that this work will provide the Congress with a better oversight of the problems and alternative solutions--possible changes in Federal and State laws--in acquiring, operating, and selling acquired multifamily housing projects. We also expect this work to encourage HUD and FmHA to look at ways the Federal Government can be more effective and economical in acquiring, managing, and disposing of multifamily projects.

NONPRIORITY LINE OF EFFORT

How Effective are Federal Efforts in Keeping Multifamily Housing in a Standard Condition?

The Housing Act of 1949, which established the national housing goal of a decent home and a suitable living environment, did not spell out the meaning of either "decent home" or "suitable living environment" nor has subsequent legislation provided a definition. Because housing quality is difficult to define precisely, progress toward meeting these goals has been difficult to measure. Since 1973, however, annual housing surveys have been taken to measure the physical condition of housing. While the indicators of housing quality used in the surveys are not perfect, the indicators do show that about 1.9 million renters in multifamily housing projects--ranging from low-rent public housing projects to HUD-insured nonsubsidized projects--have at least three or more of the following defects in their projects:

- Exposed wiring.
- Lack of complete plumbing facilities.
- Abandoned or boarded-up units.
- Rats and mice in some projects.
- Leaks in roofs.
- Holes in floors.
- Cracks or holes in walls or ceilings.

In a recent study of 228 HUD-insured unsubsidized multi-family projects, HUD estimated that it would cost about \$10.6 million to correct the deficiencies in 76 projects considered to be in serious need of repair. No estimate was given for correcting deficiencies in the remaining 152 projects.

HUD also supports a modernization program for public housing and is asking for a substantial increase in funds for this program in fiscal year 1981. HUD estimates that it may cost a total of \$4 billion including about \$360 million in contract authority to revitalize the physical condition of the public housing stock. HUD estimates that as many as 90,000 units will require substantial architectural and design changes, as well as repairs, costing as much as \$25,000 per unit. They maintain that this cost is still substantially less than the cost of replacing the units.

Individual studies have been done on the problems affecting multifamily housing and a wide range of strategies has been proposed. The strategies, however, were formulated to fit the particular type of housing--public housing, HUD-insured subsidized projects, HUD-insured unsubsidized projects, etc.--and put into separate handbooks to help Federal managers administer these separate programs. We have identified about 20 such handbooks.

Work under this line of effort would identify the extent of the physical condition of a cross section of multifamily projects, the extent of the physical decay, and alternative methods and costs of approaching some solutions to the problems. Also work would address the adequacy of Federal, State, and local efforts to correct the problems.

Current assignment

--Assessment of the extent of physical decay in a cross section of multifamily projects (CED 383210).

OUR AUDIT REPORTS

Duplicate Payments in HUD's Section 8 Program.
(CED-79-51, 3/1/79).

Report on the Need for Legislation To Reduce the Incidences of Underreporting Income in HUD's Section 8 Program (CED-9-78, 3/20/79).

Review of Selected Contracts Awarded by HUD's Cincinnati Service Office (CED-79-67, 4/12/79).

Lower Graded Military Personnel with Families Are Not Suitably Housed but Should Be (CED-79-92, 9/25/79).

Housing Leased to Lower Income Persons: Better Federal Guidance and Management Could Improve Quality (CED-80-7, 10/30/79).

Serving a Broader Economic Range of Families in Public Housing Could Reduce Operating Subsidies (CED-80-2, 11/7/79).

HUD Should Improve Its Management of Acquired, Formerly Subsidized Multifamily Projects (CED-80-31, 12/19/79).

Analysis of HUD-Insured Mortgages in Serious Financial Difficulty (CED-80-43, 1/16/80).

Analysis of DOD's Family Housing Management Account and Lease Construction Agreements (CED-80-53, 2/2/80).

Letter to Assistant Secretary for Housing-FHA Commissioner on Assessment of Security Measures Adopted by Public Housing Authorities (3/18/80).

Survey of Chicago Housing Authority's Procurement Activities (CED-80-93, 4/28/80).

CHAPTER 5

IMPROVING FEDERAL EFFORTS TO CONTROL THE

HIGH COST OF HOMEOWNERSHIP

Fewer than 7 percent of the Nation's families have incomes to afford the average purchase cost of a home without increasing their debt well beyond traditionally safe levels. In January 1980 the average selling price for new, single-family homes was \$77,100. For the first-time buyer, the poor, the elderly, and those with special needs, the housing situation is especially bleak. Rapid increases in the various component costs of housing such as land, labor, materials, and local regulations, and the high cost of mortgage money and operating costs--especially utilities--have made the American dream of homeownership an insurmountable crisis to many.

Our May 1978 report, "Why Are New House Prices So High, How Are They Influenced by Government Regulations, and Can Prices Be Reduced?" (CED-78-101), generated considerable congressional interest and has been used extensively by HUD. It is time for us to build on that work since indications are that the housing cost problem will worsen as housing demand continues to outpace supply and inflation takes on a menacing permanence. Recent Federal monetary actions to curb inflation have sent mortgage rates up over 15 percent. Many are looking to Federal leadership to ease the housing cost and affordability crisis, yet Government efforts thus far invoke little reason for optimism.

The present situation is a result of separate but interrelated factors, largely due to the unprecedented growth in the demand for homeownership since the early 1970s, prompted by

- a large post-war baby boom age group now in the prime home-buying age bracket (25 to 34);
- the advent of smaller families and working wives, giving family incomes a big boost;
- the willingness of families to spend more for housing as a means for them to bend inflation; and
- the purchase of housing for investment purposes.

Prices of new and existing homes have greatly outpaced rates of inflation and median income. From 1975 to 1979, the annual increase in new home prices averaged 13 percent, compared to a general inflation rate of 7.6 percent and growth in median family income of only 6.4 percent. The growing gap between income and housing prices has forced many families to overextend themselves by buying homes beyond the traditional

2.5-times-income measure of affordability. Homeownership costs for many extend well beyond the other traditional limit of 25 percent of their monthly adjusted income. The result could be higher home default rates and greater personal financial difficulty. For the growing number of families unable to meet minimum financial requirements, the prospect of homeownership grows slimmer with little relief in sight.

Areas which hold promise for easing the escalating cost of housing include the following:

- Regulatory reform. Although primarily a State and local concern, Federal efforts in such things as streamlining settlement procedures and use of a land registration system are possible.
- Technological innovation in the housing industry. Traditionally, builders and suppliers show reluctance to research and introduce innovations. Development at all levels in government and private industry seems minimal.
- More coordinated Federal policies. Overlapping and conflicting Federal policy actions characterize much of the Government's action in matters affecting housing costs.

Closely related to these potential solution areas are efforts to stabilize the mortgage market and utilize restructured or alternative mortgage instruments to make homes more affordable to a broader range of income groups.

Federal leadership in easing the housing cost crisis has been weak and is hampered by a variety of factors:

- Federal actions and policies are highly fragmented across many agencies, resulting in an uncoordinated network of policies and activities affecting housing--some of which are conflicting.
- The Federal role is limited, since most of the potential areas where solutions exist are in the hands of State and local governments (zoning, regulations, etc.).
- Potential solutions to ease the housing crisis lack consensus of opinion.

Few Federal actions impact favorably on housing costs and then only indirectly. Small-scale credit assistance to homeowners and involvement in secondary mortgage markets through FNMA and GNMA are the Federal Government's chief programs affecting housing costs and affordability generally. Most Federal activity increases housing costs: that is, rules and regulations which add to construction and development costs

and measures which lead to high interest rates. Current legislative initiatives affecting housing costs are limited to the Tax Exempt Mortgage Bond and Solar Development Bank bills. The mortgage bond bill aims to restrict the recent State and local practice of insuring municipal bonds to generate mortgage money at below market rates for families unable to secure money elsewhere. The solar bill would encourage construction of more energy-efficient homes and the retrofiting of existing dwellings.

OBJECTIVES

Our assignment objectives for this area of concern are:

- To evaluate the principal Federal, State, and local actions that contribute to the high cost of owning and operating a home.
- To encourage more Federal leadership in developing and adopting technological innovations and regulatory improvements in the housing industry.
- To assess ways to coordinate Federal, State, and local policies and actions to hold down the cost of housing and homeownership.

PRIORITY LINE OF EFFORT

How Effective Are Federal Efforts to Implement and Encourage Coordinated National Policies and Local Regulatory Efforts Aimed at Containing Housing Costs?

The complexity of the housing cost problem requires the coordination of many cost-containing measures to elicit an effective solution. The leadership of the Federal Government is crucial to encourage coordination, especially at the local level where the potential for more cost-effective strategies is large.

The cost to homebuilders of locally imposed policies has increased substantially in recent years, adding several thousands of dollars to the cost of a typical home. For example, exclusionary zoning practices, along with other land control measures, continue to drive up land costs on the dwindling supply of developable land. Strong Federal leadership in encouraging uniform guidelines and alternative ways of controlling growth at the local level are examples of a more effective Federal role. Apart from local regulations, more can be done to better coordinate the myriad of Federal policies and actions which affect housing costs.

Our objective is to provide answers to the following questions:

1. How extensive is the current housing affordability problem, what are the principal causes and effects, and what are the future trends?
2. Given the seriousness of the housing affordability problem, is the nature and extent of Federal leadership adequate?
3. What are the opportunities for reducing or eliminating duplicative, conflicting, or unreasonable Federal rules and regulations which adversely affect homeownership costs?
4. What can the Federal Government do to streamline and simplify State and local regulations and policies which drive up homeownership costs?

Our strategy is to increase congressional and agency awareness of the housing affordability problem and to critique the Federal leadership role in addressing the high cost of homeownership. We expect our action to result in a stronger HUD role in streamlining and coordinating policies and regulations which increase the cost of housing.

Ongoing assignments--August 1980

--The Housing Affordability Crisis - Status and Outlook
(CED 388140) (addresses all questions).

PRIORITY LINE OF EFFORT

How Effective Are the Federal Government's Efforts to Encourage the Housing Industry to Develop and Use Cost-Controlling Measures?

The housing industry has been slow to adopt innovations and improve its productivity due to the nature of the industry and lack of Federal research and support. Few major technological improvements in homebuilding have occurred since World War II since builders and developers have neither the capital nor incentive to risk new ideas on a consumer market that has had rising expectations. Only recently, in the area of solar heating and cooling technology, has Government support been forthcoming--and even here the effort is not large. There are few experiments and demonstrations of cost-reducing or more efficient housing techniques currently being funded by Government, yet the seriousness of the problem and the need for seeking alternatives to conventional building techniques require more Federal attention.

Our objective will be to provide answers to the following questions:

1. Are current housing research and development efforts adequate considering the seriousness of the affordability problem?
2. What are the barriers to innovations and technological progress in the housing industry?
3. Are there housing innovations and productivity techniques currently available warranting increased attention?

Our strategy in this line of effort is to improve agency efforts to identify and remove barriers to housing innovations and to promote more cost-reducing housing technologies. We expect our actions will improve the environment for developing and adopting cost-reducing innovations in housing.

Ongoing assignments-August 1980

- Evaluation of opportunities for innovation in housing and homeownership (CED 388170) (addresses all questions).

CHAPTER 6

EFFECTIVENESS OF FEDERAL EFFORTS TO PROVIDE MORTGAGE CREDIT AND STABILIZE FINANCING TO MAINTAIN A VIABLE HOUSING INDUSTRY

The lack of an adequate supply of mortgage credit at reasonable terms and the escalating costs of housing have created serious problems for home purchasers and builders. At the same time, the construction of private rental housing has slumped and the vacancy rate in rental housing is at its lowest level in many years.

The availability and cost of mortgage funds has been extremely volatile. The housing industry has seen no less than seven short-term periods of cyclical instability since 1948. During these periods, housing production fell an average of 40 percent from the high to the low production point. Moreover, the availability of mortgage money for certain individuals and locations in the Nation has varied. Presently, the housing industry is plagued by the Federal Reserve Board's tight money policy and high interest rates.

Because housing is a major purchase that can be deferred when mortgage funds are difficult to obtain or when interest rates are too high, demand for housing is sensitive to credit availability and interest costs. Weaknesses in the flow of mortgage funds coupled with high interest rates have caused problems for home buyers, builders, and lenders.

Housing starts fell in March 1980 to a seasonally adjusted annual rate of 1.1 million units, or 42 percent below the previous year's level. Also, mortgage interest rates rose to 17 percent and net deposits to thrift institutions remained weak at \$734 million compared with \$1.5 billion during February 1979. The housing outlook for 1980 will decline from 1979 with housing starts predicted to drop as low as 1.1 million units. Some economists expect starts to recover in the next 2 years, 1981-82, averaging about 1.9 million units each year.

The high cost and restricted availability of mortgage funds may not hurt housing as much as it did during the 1973-74 slump because mortgage funds are being generated through a myriad of new financial measures. These new financing measures include money market certificates, increasing the rate of return on savings and loan associations passbook accounts one-fourth percent above bank rates, and the temporary elimination of usury rate ceilings in 20 States. Also, in April 1980, HUD raised the FHA mortgage interest ceiling to a record 14 percent. This ceiling is also applicable to homes financed through VA programs. In May 1980 HUD lowered the ceiling to 11-1/2 percent.

The Nation's rental housing supply has declined in recent years to where the vacancy rate--5 percent--is at the lowest level in 30 years. The increasing demand for the available units has pushed rental rates up. Factors responsible for the crisis in the supply of rental housing are (1) low levels of private construction, (2) losses of existing units through abandonments and conversions, (3) increasing age of the existing rental stock, and (4) rapidly escalating operating costs.

For many years, the Congress has stressed that homeownership and the availability of rental units is vital to maintaining the Nation's economy and quality of life. It has assigned priority to those programs designed to make new and existing housing affordable to more families.

Presently, the mortgage insurance and loan guarantee programs of HUD, VA, and FmHA; the direct loan programs of FmHA and HUD; and the loan programs of the Federal land bank (FLB) system embody the Federal initiatives which can have a positive effect in making homeownership and rental units more readily available to Americans. In addition, the secondary mortgage market activities of the Government National Mortgage Association, Federal Home Loan Bank Board (FHLBB), and the Federal Home Loan Mortgage Corporation are Federal initiatives that are designed to facilitate the flow of capital into the housing sector.

Some of today's major issues that are emerging in connection with the availability and cost of mortgage funds include:

- Improving Federal efforts to promote homeownership.
- Encouraging through Federal efforts the production of a sufficient number of multifamily rental units.
- Using mortgage instruments that feature scheduled or unscheduled fluctuating monthly mortgage payments.
- Using innovative financing techniques to increase homeownership opportunities primarily for low- and moderate-income families.
- Exempting from Federal income tax interest on savings accounts to assist families in accumulating funds for a downpayment on a house.
- Reviving the Brooke/Cranston Emergency Housing Program through which HUD provides the housing sector with mortgage funds during times of declines in housing production.

- Imposing congressional limitations on the amount of Federal credit that can be incurred for housing insurance and guarantee programs. This action would result in the Federal credit agencies establishing limits on the number of loans they could insure and/or guarantee in a given period.
- Establishing congressional limitations on tax exempt revenue bonds that many cities are currently issuing to provide mortgage credit to home purchasers.
- Eliminating present usury ceilings in many States that prevent many of the Federal mortgage programs as well as private programs from being used.

OBJECTIVES

Our overall objective is to alert the Congress and Federal agencies to opportunities for improving

- the overall level of housing construction and the availability of mortgage credit,
- the Federal efforts aimed at moderating cyclical instability of the housing industry,
- the availability of mortgage financing to cover locations and households where it is not readily available,
- the long-term supply of funds for financing the housing industry, and
- the administration and coordination of the various Federal credit agencies that provide financing to the housing industry.

PRIORITY LINE OF EFFORT

Are Federal Efforts Effective in Providing Mortgage Credit at Reasonable Costs?

The lack of mortgage credit at reasonable costs and declining real incomes are factors which have led to reduced housing activity beginning in late 1979. The restricted availability of credit and high interest rates have created serious problems for potential home purchasers, renters, lenders, and builders.

During February and March of 1980, many of the Nation's leading savings and loan associations raised interest rates on conventional home loans to a range of 15 to 17 percent. In other action, the Federal Government announced on February 27,

1980, that it would impose a 12-percent interest rate ceiling on 2-1/2-year savings certificates and raise the maximum interest rate on FHA/VA mortgage loans to 14 percent. Both of these actions were aimed at increasing the dwindling supply of mortgage funds.

In January 1980 the average sales price of new single-family homes reached \$77,100 and existing homes were \$66,700. The average for new homes was up \$5,200 from a year earlier and existing homes, up \$2,200. By using the recent high in the FHA/VA interest rate of 14 percent and a mortgage amount of \$60,000 over 30 years, the borrower today is faced with a monthly payment of \$711, excluding monthly expenses for taxes, insurance, and utilities.

In October 1979 savings and loan associations reported a record \$6.8 billion outflow from their low-interest passbook accounts even though deposit flows to savings and loan associations were up \$1.23 billion for the same month because of money market certificates and certificates of deposit. Disintermediation is expected to continue for the next few months. Many investment analysts have raised serious questions on how long the savings and loan industry can continue to attract large supplies of funds through money market certificates and certificates of deposit.

Federal mortgage credit programs are aimed at increasing the supply of mortgage credit for housing. Federal credit policies are intended to supplement those of the private market, particularly in the central cities and rural areas where more risky loans are made to home purchasers and apartment developers.

To cope with the high cost of housing, HUD has implemented several innovative techniques to give increased impetus to the housing sector. HUD announced the graduated mortgage payment plan aimed at young home buyers seeking FHA-insured mortgages. Under the plan, the mortgagor will have lower monthly payments in the early years, rising with the anticipated expansion of a family's income and leveling off in later years. To encourage apartment building, HUD increased the per unit limits on the mortgage amounts that it will insure under various programs. Also, HUD has announced plans to implement its co-insurance program. Co-insurance would provide a sharing of the risk in loans and HUD would impose fewer regulations on the lenders underwriting such loans. This is a step toward revamping the slow and complex HUD procedures that have kept many lenders away from Federal housing programs. Further, HUD has announced that it plans to take aggressive action to implement its program for refinancing many of the Nation's troubled multifamily projects.

We believe that this line of effort deserves priority attention because inflation has caused serious problems for the housing industry. Federal efforts to stimulate single-family

housing construction and affordability have been insufficient to enable many families to afford housing. The Federal efforts to provide alternative mortgage instruments have come under sharp criticism from many Congressmen as well as various consumer groups. They believe that the new instruments provide insufficient safeguards for the mortgagor and may be a means by which the lenders can perpetuate high interest rates.

Concern is mounting that the Nation faces a serious shortage of rental units because of the low level of construction activity. It appears that HUD's emergency housing program for multifamily units and its program to refinance existing multifamily projects may not be sufficient steps to ensure that adequate housing will be constructed in the future, particularly for many moderate-income families.

The Congress has shown considerable interest in Federal agencies' efforts to maintain a viable housing industry through (1) designing and implementing new mortgage instruments which make it easier for people to purchase homes, (2) promoting an efficient and effective means for refinancing troubled multifamily projects, and (3) developing and implementing innovative techniques for processing mortgage loans and reducing losses. We believe that we can make a contribution to the operations of the various Federal credit agencies and point out more efficient and effective means of ensuring an adequate supply of mortgage credit.

Our objective will be to provide answers to the following questions:

1. Are the Federal credit agencies providing mortgage credit at reasonable costs?
2. Have the Federal credit agencies been aggressive in seeking innovative financing techniques to increase housing construction?
3. What are the consequences of imposing limits on the amount of Federal mortgage insurance and guarantee loans made?

Ongoing assignments--August 1980

- Review of Federal efforts to provide alternative mortgage instruments (CED 388110) (addresses question 2).
- Review of HUD's Mortgagee Review Board (CED 388160) (addresses question 1).
- Review of HUD's monitoring of mortgagee loan origination and servicing activities (CED 388180) (addresses question 1).

In the past, our attention has been focused on (1) Federal efforts to stimulate housing during periods of decline, (2) developing more equitable ways to provide housing to rural areas, (3) the insufficient number of rental units in the Nation, and (4) the impact Government regulations have had on the cost of housing. As a result of our reports, the Congress has held numerous hearings and has required changes in the housing programs. Our strategy is to provide the Congress and agency officials with more efficient and economical ways of improving administration and operation of the housing credit programs. We expect this strategy to result in agency and congressional actions to improve the operations of insurance programs, strengthen efforts which seek to implement innovative financing techniques, and provide insight into the consequences of limiting the amount of Federal mortgage insurance and guarantee loans.

NONPRIORITY LINE OF EFFORT

Are Federal Efforts Aimed at
Moderating Cyclical Instability
in the Housing Industry Efficient
and Effective?

Cyclical instability has been a major characteristic of the housing industry since 1948. The most recent decline was during the period 1974-75, when residential construction declined to a low of 953,000 units from a high of 2.5 million units.

In response to cyclical declines in housing, the Congress usually passes legislation aimed at stimulating the sale and construction of new homes. One major program is HUD's Emergency Housing Assistance Act which authorized nearly \$18 billion during the 1974-75 decline for the purchase of mortgage loans--both single-family and multifamily. We reported on the Emergency Housing Assistance Program for single-family housing in a report entitled "What Was the Effect of the Emergency Housing Program on Single-Family Housing Construction?" (Nov. 21, 1978, CED-78-155).

Congressional hearings were held in February 1980 to determine whether or not the present decline in housing activity warrants implementing the Emergency Housing Program. Administration officials and housing experts suggested that the program be authorized but that it not be implemented at the present time because key indicators for the housing industry such as construction starts, unsold inventory, and availability of mortgage credit are not at the critical levels they were in 1974.

Our 1978 report discusses, among other things, the major housing policies that need to be addressed when emergency funds are provided to the housing market. Some of the key policy questions concern the subsidy amount, the income levels of

individuals the program should be targeted to, the size of the mortgage amount, and the selling price of the home. Because of our prior work on the cyclical problems of residential construction, we do not believe that this area warrants high priority at this time. However, if the Congress passes major legislation to assist the slumping housing industry, we should consider prioritizing this line of effort.

NONPRIORITY LINE OF EFFORT

What Needs to be Done to Make
Mortgage Financing Available in
All Locations and for Low-Income
Families at Reasonable Costs?

The Farmers Home Administration provides direct and guaranteed housing loan assistance to low- and moderate-income families in rural communities with populations of less than 20,000. In addition, FmHA operates rental assistance grant, repair, and rehabilitation programs for rural areas. In fiscal year 1981, FmHA will receive budget authority for about \$4 billion for new direct and guaranteed loans and \$500 million for rural housing assistance payments.

The rural areas of the Nation have generally not had the credit lending opportunities that the cities and suburbs have had. Recently, the FHLBB has announced regulations which permit savings and loan associations to make loans above \$15,000 for housing rehabilitation and extend the maximum life of mobile homes up to 20 years. Mobile homes have become a necessary way of life in many rural areas. Presently, the major Federal supporter of rural housing is FmHA. FmHA programs are aimed at lower income people who cannot obtain conventional lending. In addition, mortgage lending by the FLB system limits its participation in housing loans to 15 percent of its total investments. Although several Federal agencies offer mortgage credit in rural areas, there are many rural people that do not qualify for existing Federal programs and, because conventional loans are not available, they are denied affordable credit for housing.

We do not believe that this line of effort warrants a high priority at this time because we have just issued a major report entitled "Ways of Providing a Fairer Share of Federal Housing Support to Rural Areas" (Mar. 28, 1980, CED-80-1). Issues affecting the rural areas of the Nation are of considerable interest to the Congress and we should continue to monitor this area.

NONPRIORITY LINE OF EFFORT

Are Federal Housing Credit Agencies
Organized in an Efficient and
Effective Manner?

The Federal Government's mortgage credit programs are aimed at increasing the supply of credit available at affordable interest rates and enhancing the liquidity of loans. Federal housing credit programs stimulate the demand for and the production of housing.

A number of Federal agencies are involved in mortgage credit activities, including (1) FHA which administers a number of mortgage insurance programs under which mortgage lenders are insured against loss in financing first mortgages on homes, multifamily projects, and loans to finance repairs, (2) VA which functions as an aid to veterans in obtaining home loans at reasonable rates, (3) FHLMC and GNMA which act as a credit facility in the secondary mortgage market, and (4) FmHA which administers farm credit and rural housing assistance offered to farmers and residents of rural areas in the form of direct loans, guaranteed loans, and grants. In addition, other Government-sponsored agencies provide assistance to housing credit agencies. They include (1) FNMA which has organized special markets for mortgage credit and extenders of commitments to purchase mortgages, (2) the FLB which has a vast network of offices and financial resources located in rural areas of the Nation, and (3) the FHLBB system which extends credit in the form of advances to its mortgage lending member institutions.

Some housing experts have suggested that many of these Federal credit agencies have fragmented and overlapping responsibilities. Questions have been asked concerning why the Federal Government sponsors both GNMA and FHLMC to stimulate financing on the secondary mortgage market. Also, questions have been raised on the administrative difficulties inherent in having three agencies--VA, FHA, and FmHA--provide insurance and guaranteed loans to help families purchase homes.

Under this line of effort we would evaluate each of the Federal credit programs which have an impact on Federal housing policy. Many of these programs have been in operation for many years and need to be reassessed to determine whether the programs have been organized to maximize opportunities that are achievable through closer cooperation and coordination.

OUR AUDIT REPORTS

What Was the Effect of the Emergency Housing Program on Single-Family Housing Construction? (CED-78-155, 11/21/78).

Rental Housing: A National Problem That Needs Immediate Attention (CED-80-11, 11/8/79).

CHAPTER 7

STRENGTHENING FEDERAL EFFORTS TO PRESERVE AND IMPROVE THE QUALITY OF LIFE IN URBAN AND RURAL COMMUNITIES

Neighborhoods and communities that provide a decent living environment for the citizens who inhabit them are essential for national stability. The Nation's goal established in 1949 for providing a decent home and a suitable living environment for every citizen has not been realized; over 30 years have elapsed, yet many citizens still live and work in deteriorated and declining neighborhoods and communities. Today, the complex social and physical problems in some of our communities threaten their viability. Many factors have combined to place heavy strains on the ability of existing public and private institutions to assure safe and wholesome living environments for all Americans.

The quality of life in communities is shaped by numerous social and physical influences as well as the actions taken by Federal, State, and local governments and the private sector. Unfortunately, past efforts to stabilize and/or improve the living environment in communities have oftentimes been simplistic--addressing only one of many adverse influences affecting the community and lacking the coordinated efforts of Federal, State, and local officials. Livable neighborhoods and communities will not be accomplished until actions are taken to consider all of the factors influencing a community and a long-term planning approach is undertaken to require the coordinated efforts of all those involved.

The concept of preserving and improving the quality of life in urban and rural communities has gained increasing prominence with the announcement of the current administration's urban and rural policy statements. These policy statements recognize that several program authorities have been enacted over the past two or three decades to deal with problems in urban and rural areas but point out that no institutional capacity exists at the Federal level for coordinating and focusing these programs in a coherent and effective way.

The continuing problems which plague our Nation's communities can be identified as

- increasing fiscal and political fragmentation resulting in an aggravating mismatch of needs and resources;
- citizen alienation and/or apathy regarding ineffective or poorly coordinated governmental action;

- housing deficiencies (lack of quality and quantity) in both decaying and blighted communities;
- transportation problems in communities: private automobiles are crowding city streets and main access roads, and mass transit is in serious trouble; consequently, effective movement of people to their jobs is becoming more and more difficult;
- problems of safety in the streets and in the home, as crime and delinquency rates rise steadily in both urban and rural communities;
- deterioration of the condition of the physical infrastructure of communities, including systems for water supply and distribution, streets, and bridges;
- education problems, with urban and rural school systems struggling to attain national standards; and
- the lag in developing community facilities in rural areas.

Over the years HUD and its predecessor agencies have administered numerous programs to curtail the physical deterioration of cities and to rehabilitate those urban areas which have deteriorated beyond the point of reasonable salvageability. Recognizing past inadequacies in the Federal community development programs, the Congress in 1974 consolidated several existing categorical programs for community development into a single program of community development block grants (CDBGs). The primary objective of the new law is the development of viable urban communities by providing decent housing and a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income. This objective is to be achieved through elimination of slums and blight and detrimental living conditions; conservation and expansion of housing stock; increased community services; improved use of land; spatial deconcentration of housing opportunities; and preservation of property with historic, architectural, or esthetic value.

There is an array of Federal programs, administered by several agencies, providing financial support for community preservation and improvement in urban and rural communities. This support is provided through grants, direct loans, loan guarantees, and technical assistance to States and local governments. In fiscal year 1979, approximately \$6.7 billion was appropriated for community improvement and preservation. Current projections indicate that funding for these programs over the next 4 fiscal years, ending in 1983, will total about \$28 billion.

The major programs for improving and preserving the quality of life in urban and rural communities include:

- HUD's Community Development Block Grant Program.
This program provides grants totaling about \$4 billion annually to some 3,000 communities. These grants can be used to support a wide range of activities based on local priorities.
- Department of Agriculture programs for water and sewer systems, community facilities, and planning assistance. These programs provide grants, direct loans, and loan guarantees to principally rural communities.
- Other Federal programs relating to transportation, schools, public health, and employment.

These assignments will be closely coordinated with our General Government Division's Intergovernmental Relations and Revenue Sharing staff and our Human Resources Division's Community Services Administration staff.

OBJECTIVES

Our overall objective is to provide information that will identify ways for the Federal Government to improve

- the capability of communities to implement community development activities;
- the effectiveness of Federal, State, and local efforts to preserve and improve existing housing stock;
- the effectiveness of Federal efforts to eliminate slums, blight, and conditions which are detrimental to health, safety, and public welfare;
- the effectiveness of communities' planning to assure the proper balance among residential, commercial, industrial, and recreational activities;
- neighborhood revitalization without causing displacement of lower income families; and
- community development in small cities and rural areas.

PRIORITY LINE OF EFFORT

How Efficient and Economical Are
Federal Efforts to Preserve and
Revitalize Urban Communities?

The block grant program is a \$4 billion a year program designed to develop viable urban communities by providing lower income families decent housing and a suitable living environment and by expanding their economic opportunities.

In general, the funds may be used for activities eligible under previous programs. These activities may include

- acquiring real property;
- acquiring, constructing, or installing public works, facilities, and site improvements;
- clearing, demolishing, removing, and rehabilitating buildings;
- providing public services; and
- enforcing codes.

Our objective will be to provide answers to the following questions:

1. What controls has HUD established to ensure proper fiscal management by program recipients?
2. How does HUD monitor various programs to determine success or failure?
3. Is there too much flexibility to result in attainment of national goals?
4. Would the activities/projects financed have happened without Federal funds?
5. Are Federal funds expended for rehabilitation cost effective?
6. How does HUD coordinate the CDBG Program with other Federal community development efforts?

About \$20 billion has been authorized and appropriated during the 6-year period of the CDBG Program's existence. Because the program was relatively new, in the past, we reviewed only specific CDBG activities or functions. Our strategy now, however, is to conduct a comprehensive review of the entire program to increase congressional awareness of needed improvements or to suggest necessary changes in program direction. Additionally, our efforts will encourage agency action to improve achievement of national community development goals through more efficient, economical, and coordinated community development programs functioning throughout the country. We expect our efforts to result in better and more efficient use of public and private resources so that the

need for budget increases in the community development area will be minimized.

Ongoing assignments-August 1980

--Assessment of the Community Development Block Grant Program (CED 384800) (addresses all questions).

PRIORITY LINE OF EFFORT

How Effective Is the Nation's Comprehensive Rural Development Policy?

Since a 1970 congressional policy declaration that "the highest priority must be given to the revitalization and development of rural areas," administration study groups have been reviewing both the design and organization of Federal rural development programs. These efforts resulted in the administration's December 1979 Small Community and Rural Development Policy--the Nation's first comprehensive rural policy.

This policy was designed to recognize the great diversity of rural needs and circumstances and is intended to coordinate Federal efforts with those of State and local governments and the private sector to solve problems and improve the quality of rural life. Its goals are to

- create new rural jobs,
- provide a favorable climate for rural business and economic development,
- promote the responsible use of America's natural resources,
- address the special rural problems of distance and size, and
- meet the basic human needs of rural Americans.

Overall, this policy addresses over 200 Federal programs currently included in 15 of our approved issue areas. Our objective will be to analyze broad-based policy questions and approaches underlying Federal assistance to rural areas. We believe this information will aid (1) the administration in modifying or clarifying its policy and (2) the Congress, which is currently considering legislation that would provide statutory authority for a permanent rural policy process in the executive branch, as well as legislation dealing with the various components of rural development. Our strategy is to provide information on the following two questions:

1. What policy changes are needed to uniformly provide assistance to rural areas?
2. How effectively does the rural development policy foster balanced national growth?

Ongoing assignments--August 1980

--Definitional problems in providing assistance to rural areas (CED 069230) (addresses question 1).

NONPRIORITY LINE OF EFFORT

How Effective and Coordinated Are Federal Efforts to Provide Essential Facilities and Services in Rural Communities?

Rural communities generally have proportionately greater unmet basic needs--housing, water and sewer, health, education, income maintenance, transportation, and social and legal services--than do other parts of the Nation. Even worse, access to health care and transportation has actually deteriorated in some rural areas during recent years.

Over the years the Federal Government has initiated numerous programs through many different agencies to address these problems. For example, there are currently 46 sewage-related programs dispensing \$6 billion through 7 agencies in 5 departments, 2 independent agencies, and 8 regional commissions. Likewise, in the transportation area, 60 grant assistance programs are channeled to rural areas through 6 semi-autonomous operating groups in the Department of Transportation as well as an additional network of 25 agencies.

As is typical of rural development work, we envision that this line of effort will intersect many of our approved issue areas. However, the focus of our work will be somewhat different--that is, to examine how the Federal delivery of essential facilities and services can be changed to improve the quality of life of rural residents.

NONPRIORITY LINE OF EFFORT

How Effective Are Local Communities in Administering Community Development Activities?

There is growing concern in the Congress that funds available under the Community Development Block Grant Program and other programs are not being spent fast enough, resulting in the Congress' reluctance to authorize additional increases in the current funding of the programs. In the first 4 years of the CDBG Program, for example, only about 58 percent of the funds appropriated by the Congress have been expended by

grantees. While there are varying reasons why communities are experiencing the slow drawdown of appropriated funds, one of the reasons is the difficulty communities have in implementing the program. HUD, in this regard, has an inherent program responsibility to identify, through its monitoring efforts, those communities lacking the capability to implement the programs and to offer technical assistance to overcome these weaknesses.

Our objective is to evaluate and provide information that will lead to increased awareness of ways that local communities can improve their administration of community development activities.

Current assignments

--Evaluation of the capacity of small cities 1/ to effectively use community development program funds (CED 384760).

OUR AUDIT REPORTS

Review of a HUD Innovative Grant for a Children's Museum in the District of Columbia (CED-79-20, 12/5/78).

Proposed Demolition of Kann's Department Store by the Pennsylvania Avenue Development Corporation (CED-79-71a, 3/31/79).

Should the Appalachian Regional Commission Be Used as a Model for the Nation? (CED-79-50, 4/27/79).

More Can Be Done To Identify and Help Communities Adjust to Economic Problems Caused by Increased Imports (CED-79-42, 5/19/79).

Technical Assistance Contracts Awarded to Neighborhood Organizations under Section 107 of the CDBG Program (CED-9-98, 6/4/79).

Urban Homesteading: A Good Program Needing Improvement (CED-80-3, 11/13/79).

Millions of Dollars for Rehabilitating Housing Can Be Used More Effectively (CED-80-19, 12/7/79).

1/ Under 50,000 population.

Need for Better Cash Management in HUD's Section 312
Rehabilitation Program (CED-80-74, 3/28/80).

Rural Electrification Administration Loans to Electric
Distribution Systems: Policy Changes Needed (CED-80-52,
5/30/80).

Status of the Youngstown, Ohio, Community Development Block
Grant and Urban Development Action Grant Eligibility
(CED-80-121, 7/25/80).

Analysis of Community Development Block Grant Drawdown
Rates (CED-80-137, 8/20/80).

CHAPTER 8

ASSISTING COMMUNITY DEVELOPMENT THROUGH

LOANS AND GRANTS TO BUSINESSES

The economic and social health of the Nation's communities depends largely on the vitality of their taxpaying, employment-providing businesses. But many people interested in establishing or expanding businesses are handicapped by inadequate credit and management know-how and find it difficult to compete with foreign businesses or the domestic corporate giants. Minorities and others who suffer from social or economic disadvantages find it particularly difficult to create and maintain viable businesses. The American farmer--the provider of products vital to continuing economic health, domestically and internationally--has an acute need for financial assistance to supplement credit available from private lenders. To help businesses overcome these problems, several Federal agencies operate programs designed to give financial, procurement, marketing, and management assistance to business.

The Federal Government has identified certain segments of the business sector for special assistance, including small businesses, minority-owned businesses, businesses including farmers located in rural or depressed areas, and businesses facing intense foreign competition.

The Small Business Administration estimates that there are about 13.2 million small businesses in the United States. Each year numerous small businesses fail due to inadequate financing and poor management. SBA recently found that small businesses have the same kinds of problems as larger businesses but suffer from them to a greater extent and concluded that "by almost every measure, small firms fare worse under changing economic conditions than do large businesses." Each business failure adversely affects the community.

Small businesses have extreme difficulty obtaining financing at reasonable rates because of the high risk associated with small businesses. Also small business owners often lack the education and resources necessary for a viable business. Good management is critical to the success of a business as indicated by estimates that 9 of 10 business failures are attributable to management deficiencies. Problems facing small business appear to have increased rather than diminished during the past years. Based on these trends, SBA projects that life will get harder rather than easier for businesses during this decade.

The problems of minority businesses are generally even more severe than for small businesses. A lack of a business tradition, language barriers, and racial discrimination are factors that limit opportunities for minority business ownership.

Economic conditions in rural areas are often not conducive to business growth due to inadequate financing and public services such as transportation and health services. Recent legislation has committed the Nation to revitalize and develop rural areas as a means of achieving a balanced national growth. The development of businesses in rural areas is essential and has been emphasized in the Rural Development Act of 1972 and the President's recent Small Community and Rural Development Policy.

Our Nation has grown and prospered economically over the past three decades, but this prosperity has not been evenly distributed among areas of the country. Many areas have remained economically stagnant. The Economic Development Administration provides business development loans to encourage business and industry to build or expand in the depressed areas.

Title II of the Public Works and Economic Development Act of 1965, as amended, established EDA's Business Development Assistance Program to provide direct and guaranteed loans and interest subsidies to private businesses. EDA's pending reauthorizing legislation (S. 914 and H.R. 2063) provides approximately \$1.8 billion in loan authority for this program. This represents about a fourfold increase in the program's historical level of funding.

Over the years legislation has been enacted to protect the domestic producer from foreign competition and also to promote more open and equal international trade. In passing the Trade Act of 1974, the Congress recognized that increased imports resulting from expanding international trade could adversely affect certain firms within the United States. Therefore, the Congress provided monetary assistance for those firms injured by imports. This assistance was designed to bring about an adjustment to changed economic conditions caused by international trade patterns.

OBJECTIVES

Our objective is to report on ways that the Federal Government can

- improve the delivery of Federal assistance to small businesses,
- improve community development through the viability of businesses, and
- be more effective in considering the views and problems of the small business community.

PRIORITY LINE OF EFFORT

How Effective and Efficient Are Federal Programs Designed to Develop Viable Firms Owned by Minority and Other Special Groups?

Recent years have been very important for minority small businesses. One important factor was the implementation of the Local Public Works Act-Round II. The act established a minority participation goal of at least 10 percent of \$4 billion in contracts let by the States and local municipalities. That goal was exceeded by 60 percent when minority firms received about 16.5 percent (\$663.5 million) in contracts.

The section 8(a) program is perhaps the most important Federal effort to develop viable minority small businesses. It has been used to direct Federal contracts to socially or economically disadvantaged controlled firms in the belief that these small businesses would slowly develop their business abilities. With the support of management and technical assistance from SBA's business development specialists, the firm theoretically was to "graduate" into the free enterprise system and compete for regular non-8(a) business. In over 10 years only 139 out of over 4,300 firms have graduated. Perhaps the key reason for the high failure rate of 8(a) firms has been a lack of a concerted effort on the part of SBA to carry out an effective business development function. This has resulted in (1) limited contracts going to firms both from Federal contracting and the private sector, (2) inadequate level of management and technical assistance, and (3) firms not being able to obtain contracts due to bonding limitations. To deal with these problems, the Congress enacted Public Law 95-507 which in part created the Minority Small Business and Capital Ownership Development Program (the 8(a) procurement program). This program is SBA's primary effort to promote and facilitate equal access for socially and economically disadvantaged businesses into the business sector.

SBA has continued its emphasis of providing financial assistance to women business owners. While women make up more than half the population of the community, they have a controlling interest in fewer than 5 percent of its businesses. SBA is committed to an all-out effort to assist them. For example, business loans to women rose from \$168.5 million in 1976 (8 percent of total dollars loaned) to \$444.4 million in 1978 (16 percent of total dollars loaned).

In 1979 the Department of Commerce made a policy shift when it created the new Minority Business Development Agency (formerly known as the Office of Minority Business Enterprise) with a shift of emphasis toward helping medium-sized minority firms. Previously assistance was aimed at minority businesses making up "mom and pop" stores struggling for survival in ghettos. Commerce now contends that with the new mission the

Office can do more to help medium-sized firms, thus producing jobs that will add stability to communities and improve the overall economy.

Public Law 95-507 requires us to audit and evaluate SBA's Minority Small Business and Capital Ownership Development Program. This includes the Economic Opportunity Loan Program, the Call Contract Management Assistance Program, the 8(a) program, and the waiver of Federal bonding requirements for selected 8(a) firms. We are also required to audit a 2-year pilot project for negotiating contracts for the 8(a) Program and a new subcontracting program under section 7(j)(3) of the act. Three of these audits are underway.

Our objective is to address the following questions:

1. How many borrowers of economic opportunity loans have established lasting businesses?
2. What has caused Economic Opportunity Loan borrowers to default on their loans and terminate their businesses?
3. Have recent legislative changes ensured greater Federal efforts in providing contracting opportunities for minority enterprises?
4. Has SBA established adequate controls within its total system to ensure that minority firms receive needed assistance and that Federal funds are effectively used?
5. Do SBA's objectives and goals for assisting other special groups offer a sound approach to meeting their needs?

Our strategy is to fulfill our legislative requirements and improve the efficiency and effectiveness of Federal assistance programs for minority and special groups. Our actions should result in needed management improvements in several of SBA's key programs.

Ongoing assignments-August 1980

- Effectiveness of SBA's Economic Opportunity Loan Program (CED 077890) (addresses questions 1 and 2).
- Evaluation of SBA's 8(a) procurement program (CED 077960) (addresses questions 3 and 4).
- Evaluate the impact of Federal efforts to promote women-owned businesses (CED 077030) (addresses question 5).

--Evaluation of the results of a pilot contracting method under SBA's 8(a) procurement program (CED 077970) (addresses questions 3 and 4).

PRIORITY LINE OF EFFORT

Are Federal Financial Assistance Activities Meeting the Needs of the Business Community?

SBA continues to make a record number of loans to small businesses. In fiscal year 1978, for example, SBA made business loans totaling \$3.31 billion. The average loan size was \$104,328 (compared to \$95,914 in 1977) which is a continuation of a trend over the past few years which has been a result of inflation and higher legislative ceilings on SBA loans.

SBA establishes maximum allowable interest rates for immediate participation and guaranteed loans and for its guaranteed line of credit plans. The rates are based on a continuous survey of the market for fixed income securities, both Federal and private, and on the prevailing rate for loans as determined by SBA field personnel. The rates are periodically reviewed and adjusted. Because of rapidly rising interest rates, SBA made three adjustments in fiscal year 1978. SBA changed this practice on September 21, 1979, when it established a policy that the maximum interest rate on SBA-bank guaranteed loans is automatically raised to one-half percentage point over the minimum prime New York rate. This action was due to the unprecedented escalating interest rate situation and will be reexamined if the prime rate drops to 11 percent.

Recently prime interest rates, as high as 20 percent, have become a heavy burden on small businesses. In 1979 SBA told its loan officers to be responsive to requests from businesses seeking adjustments in loan repayment. It is the SBA Administrator's hope that, by deferring loan repayments or providing management assistance, SBA can prevent the layoff of employees and help the firms remain viable.

Also, in the last several years, there has been a movement toward getting the loan-making responsibility out of SBA and into the banking institutions. In September 1976 SBA pilot tested its accelerated Bank Guarantee Program. Under this program selected banks, using SBA-established criteria, determined the creditworthiness of 7(a) loans, and SBA could deny a loan approval if the applicant was not eligible because of size or type of business; SBA had an unsatisfactory experience with the applicant on an existing loan; or SBA had information contrary to that supplied by the lender or applicant concerning the application. SBA terminated the program in March 1977 in favor of a "Bank Certification Program."

Under the certification program, private lenders which have participated satisfactorily in the 7(a) loan program would be certified and delegated responsibility for evaluating loan applications and for recommending loan approvals to SBA. SBA relies on the certified lenders' recommendations and approves recommended loans without further review. SBA started the program with 29 selected bank participants.

SBA also stimulates activity in a secondary market for the guaranteed portion of SBA loans. A bank can sell the guaranteed portion in the investor secondary marketplace, and the proceeds from the sale can be reinvested in other small businesses. Being able to liquidate such loans quickly can influence banks to be less reluctant to make the longer term loans needed and desired by small business.

S.914 and H.R. 2063 authorize EDA to make direct and guaranteed loans and interest subsidies to businesses. Substantial funding of these new programs is anticipated. The proposed legislation contains provisions mandating us to review the Business Development Loan Program.

Business finance plays a very important part in developing communities. Recognizing this, the Congress, through programs and activities of SBA, EDA, and FmHA, continues to pursue ways to help small businesses. This priority line of effort concentrates on jobs aimed at making Federal efforts more effective. In addition, our work at EDA will be mandated by the Congress when the bills become law.

Our objective is to address the following questions:

1. Should banking institutions assume more of the loan-making responsibility from SBA?
2. How can the Federal Government improve its technical and management assistance to private businesses?
3. Are Federal business assistance programs achieving the legislative and executive objectives?
4. Is Federal assistance restricted to businesses having an actual need?
5. What factors affect a bank's decision to participate or not to participate in SBA's guaranteed loan program?
6. Is the level of complexity in processing SBA guaranteed loans greater, the same as, or less than regular commercial loans?

Our strategy is to encourage agency adoption of improvements in the many financial assistance programs available to businesses, and to fulfill potential legislative review requirements of the Business Development Loan Program. Our actions should result in more efficient and cost-effective financial assistance programs in SBA, EDA, and FmHA.

Ongoing assignments--August 1980

- Effectiveness of delivery systems used by SBA to provide assistance to businesses (CED 077900) (addresses questions 2, 5, and 6).
- Impact of SBA's displaced business loan program on small firms injured by Government actions (CED 077950) (addresses questions 2, 3, and 4).
- Evaluation of the adequacy of the control and disposition of collateral by Federal agencies which lend to businesses (CED 077980) (addresses question 5).
- Feasibility of consolidating SBA's, EDA's, and FmHA's business development assistance programs (CED 069240) (addresses questions 2, 3, and 4).

PRIORITY LINE OF EFFORT

Have Federal Management Services and Technical Assistance Helped Small Businesses Overcome Problems?

SBA and EDA have management assistance programs to foster the establishment, growth, and success of small businesses. This assistance is needed because managerial deficiencies cause 9 out of 10 business failures. Many of these business failures could have been avoided had the owners received management assistance in time.

SBA operates its management assistance program throughout its field offices with assistance from a number of volunteer groups and paid consultants. EDA operates a similar program through universities. The Congress is currently considering S. 918, a bill to reauthorize programs and activities of SBA. The legislative committees in their discussion of this bill have indicated that they will be requesting us to audit the Small Business Development Center Program.

In a variety of cases, we previously pointed out that SBA did not provide management assistance to all firms that requested it, and when it was provided, it was not always timely. By enacting Public Law 95-507, the Congress added a new call Contract Management Assistance Program that exclusively serves the needs of 8(a) program participants.

Under this priority line of effort we will undertake assignments mandated by the Congress. Our objective will be to address the following questions:

1. How qualified are the federally funded management service firms?
2. How effective is management assistance provided to small businesses?

Our strategy is to fulfill our legislative requirement to evaluate the Small Business Development Center and to encourage agencies to improve the effectiveness of their management assistance programs. We expect our actions will result in more program efficiency in SBA's management assistance.

Ongoing assignments-August 1980

--Effectiveness of business and management assistance programs administered by SBA and Commerce (CED 077910) (addresses questions 1 and 2).

--Evaluate the effectiveness of SBA's 7(j) management assistance program (Public Law 95-507) (CED 077000) (addresses questions 1 and 2).

PRIORITY LINE OF EFFORT

How Effective Are Federal Loan Programs for Farmers?

The Federal Government's recent actions to limit credit to help slow down inflation has further intensified farmers' difficulty in obtaining credit. The "average" farmer usually borrows about \$50,000 each spring for fuel, fertilizer, and other farm necessities. Farmers that can get credit are paying 15 to 18 percent for operating loans compared to about 10 percent last year. Many farmers are finding that their usual lenders--rural banks and production credit associations--are severely limiting any new credit. Therefore, farmers are looking to FmHA for financial assistance. In fiscal year 1981 FmHA received an extra \$2 billion in emergency loan funds, but this came too little and too late to save many farmers. During fiscal year 1981 FmHA will provide \$3.8 billion in loans to individual farmers.

Recently a series of hearings has been held on problems confronting farmers. In addition, the Chairman, House Subcommittee on Family Farms, Rural Development, and Special Studies, Committee on Agriculture, recently met with the Comptroller General and emphasized that farmers are faced with

a cost-price squeeze that threatens the survival of the family farm.' Of highest concern is the need to provide credit at reasonable cost to the farmer.

We have consistently maintained a high level of audit activity of FmHA loan programs. More recently, however, we have limited our audits to those areas experiencing active congressional consideration. We recently issued reports on the coordination among farm credit lenders, Farm Credit Administration's assistance to farmers, and FmHA's Economic Emergency Loan Program. Our future assignments will address the following questions:

1. Do Federal farm lending programs provide an appropriate share of long- and short-term credit available to farmers?
2. How can Federal farm lending programs be modified to incorporate current state-of-the-art lending techniques?
3. Do Federal farm lending programs target assistance to farmers with the greatest need?
4. Do Federal farm lending programs help farmers to improve their financial profiles and reduce their dependence on credit financing?

Our strategy is to encourage agency adoption of techniques designed to improve loan management effectiveness. Our actions should result in loan programs better matched to farmer needs.

Ongoing assignments--August 1980

None

NONPRIORITY LINE OF EFFORT

Are the Problems of Small Businesses Adequately Addressed by the Federal Government?

Section 2(a) of the Small Business Act provides that SBA is to aid, counsel, assist, and protect, insofar as possible, small businesses in order to preserve free competitive enterprise. Moreover, the Congress enacted Public Law 94-305 on June 4, 1976, that established within SBA an Office of Advocacy. The Office has two objectives--reduce the burdens that Federal policies impose on small firms and maximize the benefits small firms get from the Government.

The Office has been set up to perform three functions. The first is a general function of receiving complaints from

small business and giving assistance in its dealings with the Federal Government. In its second function, the Office attempts to monitor the various regulations and policies of the Federal Government that affect small businesses, develop proposals for revising those policies when needed, and communicate those recommendations to the Federal agencies involved. The Office's third function attempts to assess (1) the current status of small business in the economy, (2) small businesses' potential contributions to the Nation's economic well-being, and (3) the effects of the Federal Government's various activities on small businesses' success.

SBA's main purpose is to provide financial assistance to small business concerns through several programs and activities. The assistance is generally provided by financial institutions which deal with and are regulated in some cases by SBA. Since the agency as a whole deals with multiple functions, the Congress saw the need to have an advocacy function within SBA to answer the needs of small businesses having difficulty dealing with Federal agencies. Thus, the concerns here are whether the Office of Advocacy has effectively performed its responsibilities under the act. We have shown in our previous reports that SBA oftentimes performs its financial assistance role while ignoring the advocacy role.

OUR AUDIT REPORTS

Adjustment Assistance to Firms under the Trade Act of 1974--Income Maintenance or Successful Adjustment? (ID-78-53, 12/21/78).

Minority Firms on Local Public Works Projects--Mixed Results (CED-79-9, 1/16/79).

Allegations Regarding the Small Business Set-Aside Program for Federal Timber Sales (CED-79-8, 4/5/79).

Observations Made on SBA's Small Business Development Centers (CED-79-113, 7/24/79).

Efforts to Improve Management of the SBA Have Been Unsatisfactory--More Aggressive Actions Needed (CED-79-103, 8/21/79).

Measuring Accomplishments under the Business Development Assistance Program--More Accurate Verification Recommended (CED-79-117, 9/6/79).

The Surety Bond Guarantee Program: Significant Changes are Needed in Its Management (CED-80-34, 12/29/79).

The Farm Credit System: Some Opportunities for Improvement (CED-80-12, 1/25/80).

The Cooperative Extension Service Should Provide
Farmers with More Information on Farm Credit
Sources (CED-80-45, 2/27/80).

The Farmer's Home Administration Economic
Emergency Loan Program Could Be More Effective
(CED-80-84, 3/28/80).

Small Business Administration Franchise Loans:
Risk of Loss Can Be Reduced and Program
Effectiveness Improved (CED-80-47, 4/11/80).

Status Report on Small and Small Minority
Business Subcontracting and Waiver of Surety
Bonding for 8(a) Firms (CED-80-130, 8/20/80).

CHAPTER 9

EFFECTIVENESS OF FEDERAL EFFORTS TO ASSIST

ECONOMICALLY DISTRESSED COMMUNITIES

Economically distressed communities, both large and small, are located in every region of America. Burdened with too few jobs and too little income, these communities have a wide variety of severe economic problems. Although these problems cannot be treated alike, distressed communities share the following common characteristics:

- Their residents suffer from high unemployment and low family income.
- Their population growth is often below average, sometimes even declining.
- Their young people leave for better opportunities, taking with them badly needed skills and energy.
- They find it increasingly difficult to support schools, hospitals, and other public facilities.
- They are often too poor to provide and/or protect public structures needed to attract new businesses and new jobs.

While degrees of distress vary, economic problems are widespread. For example, more than 45 percent of the Nation's population (102 million persons) live in communities or areas in which unemployment has been above the national average for more than 5 years. About 15 percent live in communities with average incomes of less than 80 percent of the national average. Also, studies have shown that half of the Nation's cities with populations greater than 500,000 and one-fourth of the cities over 50,000 are economically distressed. Likewise, many of the Nation's small communities are economically distressed. For example, about three-fourths of all rural people live in or near towns of less than 20,000. Given their small population bases, many cannot attract enough private investment to provide jobs to their residents, nor do they have the private sector tax base needed to support essential public services. These communities require special targeted aid to bring in new permanent private sector jobs and investment.

The Carter administration announced in March 1978 the first National Urban Policy to address comprehensively the problems and needs of America's cities and neighborhoods. Among other things, the policy calls for providing fiscal relief to the most hard-pressed communities, providing strong incentives to attract private investment to distressed communities, expanding business

and job opportunities for the urban poor, and reducing urban sprawl. Major changes in existing Federal programs aimed at cities have been made and new programs and initiatives have been established.

In December 1979 the Carter administration announced a Small Community and Rural Development Policy. This policy is designed to recognize the great diversity of rural needs and circumstances. One of its goals is to provide opportunities for rural people to be fully and productively employed and a favorable climate for business and economic development. Federal agencies have been directed to target Federal assistance to disadvantaged persons and distressed communities in rural areas.

OBJECTIVES

We plan to direct our future assignments under this area of concern toward helping the Federal Government in three basic objectives:

- Improving the planning and coordination of Federal efforts to assist economically distressed communities.
- Improving the implementation of Federal economic development programs and initiatives.
- Encouraging State governments to invest in economically distressed communities.

PRIORITY LINE OF EFFORT

How Effective and Economical Are Federal Efforts in Helping to Stimulate Economic Growth in Distressed Communities?

EDA is at the forefront of the Federal Government's efforts to respond to the needs of distressed communities. The agency's primary mission is to promote the long-term recovery of economically depressed areas by reducing unemployment and underemployment, increasing the incomes of residents, strengthening the tax base of local communities, and assisting in the construction of facilities which provide essential services to low-income groups. EDA administers a wide range of programs to carry out this mission, including planning and technical assistance grants, public works grants, and direct loans and guarantees to private businesses.

Also, HUD plays a major role through its Urban Development Action Grant Program (UDAG) in assisting economically distressed communities. UDAG provides grant assistance to communities to help alleviate physical and economic deterioration through stimulation of commercial and industrial development and the reclamation of deteriorating neighborhoods. The success of EDA's and HUD's efforts in stabilizing and improving local

economies depends largely upon the capacity of localities to coordinate these efforts with other Federal, State, and local programs.

Recently, the administration and the Congress have assigned higher priority to EDA and HUD programs aimed at helping to stimulate economic growth in distressed communities. For example, the UDAG Program was funded \$400 million and \$675 million in fiscal years 1978 and 1980, respectively.

To carry out its oversight responsibilities, the Congress needs to know whether EDA's and HUD's economic development programs are administered in an efficient, effective, and economical manner and in accordance with congressional intent. Our work will address the following questions:

1. Are Federal programs to assist distressed communities adequately coordinated?
2. How can the Federal Government improve its delivery of funds to distressed communities?
3. Who benefits from the Federal funds to distressed communities?
4. Are the most pressing problems in distressed communities receiving priority attention?

Our strategy is to encourage better coordination of Federal efforts to assist distressed communities and to improve agency assistance to the appropriate need. We expect our actions to result in a better matching of Federal assistance to the most important State and local needs.

Ongoing assignments--August 1980

- Review to determine if EDA needs to improve its management of industrial parks to maximize project accomplishments (CED 069160) (addresses questions 2 and 3).

NONPRIORITY LINE OF EFFORT

How Effective Are Federal Efforts
Designed to Help Distressed Communities
Develop Comprehensive Plans?

There are growing congressional and executive concerns over urban and rural economic development problems, such as erosion of urban areas and disproportionately high levels of unemployment among certain population groups. To address these concerns in ways consistent with national and local policies

and priorities, distressed communities must be able to pinpoint their problems, measure their resources, recognize their opportunities, and package economic development assistance. Effective planning is a critical element in this process. Studies by us, outside consultants, and the President's Council on Balanced National Growth and Economic Development have cited numerous examples of duplication of effort and less than effective expenditures of Federal funds largely attributable to weaknesses in planning processes. Reportedly, many communities have improved their planning capabilities; however, State officials, mayors, and city managers concede that they have a long way to go before comprehensive plans are developed to link economic and community development matters with social services and environmental concerns.

EDA and HUD have programs supporting planning activities at the State, county, and local levels to encourage development of comprehensive policies and strategies for dealing with economic needs. Also, these agencies, along with the Department of Labor and FmHA, finance a wide range of technical assistance projects, both individually and jointly, to improve the management and planning capacity of distressed communities.

NONPRIORITY LINE OF EFFORT

How Effective Are Federal Efforts
to Target Community Development
Assistance to Economically Distressed
Urban Areas?

Recent studies of urban conditions, including those of the Brookings Institution, have concluded that the United States does not have a national urban crisis, but certain cities have serious urban problems. Because the problems are more concentrated in some urban areas than others, it is important that limited Federal assistance be effectively coordinated and targeted to areas with the greatest need. Actually, two tiers of targeting exist. The first involves allocating assistance to the most needy jurisdictions and the second involves targeting the assistance to the most needy neighborhoods within the generally distressed jurisdictions. In both situations several Federal agencies provide similar assistance.

The first tier of targeting is defined differently by various Federal agencies, and it provides for a surprisingly high percentage of eligibility. For example, EDA targets its assistance to the most needy 80 percent of all jurisdictions, while the UDAG Program targets assistance to about 50 percent of all jurisdictions. In addition, the second tier of targeting has not been well defined by the agencies involved. Consequently, there is no assurance whether the targeted Federal funds are going to the areas of greatest need nor whether overlapping and duplicative assistance is available.

We plan to direct our work in this line of effort to the following objectives:

- To what extent do Federal programs overlap and duplicate one another, and are jurisdictions shopping around at the various Federal, State, and local assistance agencies for the best deal?
- Should the first tier of targeting Federal assistance be better defined, and are funds actually being used to assist that part of the distressed community most in need?
- Are lower income people benefiting most from the Federal efforts as required by law?
- Do Federal efforts mesh with an overall plan of improvement for upgrading the distressed community?

NONPRIORITY LINE OF EFFORT

Are Economic Problems of Rural Communities Being Adequately Addressed by the Federal Government?

Economic development problems facing rural communities include inadequate public facilities (water and sewer), threatened closure of air and rail service, and limited access to credit and capital. These and other problems of comparable severity inhibit the growth of businesses, resulting in disproportionately high levels of unemployment and poverty in rural areas. For example, about 40 percent of the Nation's poor reside in rural areas.

Early in this Nation's history, three-fourths of all employed rural residents worked in farming. With the adoption of new farm technology, however, the number of rural residents employed in farming is decreasing dramatically but rural populations are increasing. This, coupled with the demand for part-time jobs to supplement dwindling farm incomes, has greatly increased the need for private and public investment to create nonfarm employment in rural areas.

Currently the Federal Government has over 100 different programs in more than 10 different agencies to provide financial and managerial business assistance. In addition, 10 agencies administer 24 employment and training programs. The Government also has additional opportunities to generate rural employment by siting Federal facilities in those areas.

Both the President and the Congress are committed to an active role by the Federal Government in working with State and local governments to more effectively address these problems

in the 1980s. These commitments have been translated into rather specific policy objectives for rural development announced by the President in December 1979. However, a statement of policy goals and principles is not enough. These goals and principles will only begin to affect the needs of rural Americans as they are reflected in changes in the way the Government acts--changes in programs, in delivery systems, and in accessibility.

Several agencies have announced changes to reflect the intent of the President's policy objectives for rural development. Whether these changes are successfully implemented, adequately address economic development needs, and result in anticipated benefits to rural communities are questions which require careful monitoring and evaluation.

OUR AUDIT REPORTS

Criteria for Participation in the Urban Development Action Grant Program Should Be Refined (CED-80-80, 3/20/80).

Status of HUD's Urban Development Action Grant for the Parkway Center Shopping Mall in Pittsburgh, Pennsylvania (CED-80-110, 6/26/80).

CHAPTER 10

EFFECTIVENESS OF FEDERAL PROGRAMS IN ASSISTING COMMUNITIES TO PREPARE FOR AND RECOVER FROM CATASTROPHES

Over 25 Federal agencies provide some form of disaster assistance to States, local communities, individuals, and businesses. The more significant types of assistance provided in a major disaster are temporary housing; individual, business, and farmer loans; family grants of up to \$5,000; and grants to State and local governments for repair or replacement of public facilities such as roads, bridges, and public utilities and buildings.

Federal emergency preparedness activities have been dispersed among a number of Federal agencies. However, in April 1979, the Federal Emergency Management Agency was established as an independent agency. FEMA consolidates the major Federal emergency preparedness/disaster relief programs. FEMA was created by transfer of the following:

- Defense Civil Preparedness Agency (from Defense).
- Federal Disaster Assistance Administration (from HUD).
- Federal Preparedness Agency (from the General Services Administration).
- Federal Insurance Administration (FIA) (from HUD).
- United States Fire Administration (from Commerce).
- The Federal Emergency Broadcast System oversight responsibility (from the Office of the President).

In addition, the Director of FEMA is chairman of an emergency management committee consisting of the Director, Office of Management and Budget, and assistants to the President for National Security, Domestic Affairs and Policy, and Intergovernmental Relations. This committee will set agency policy and advise the President on civil emergency situations.

For major disasters declared in fiscal year 1979, FEMA (or its predecessor agency, Federal Disaster Assistance Administration) provided an estimated \$448 million in assistance to individuals, States, and local governments and private nonprofit organizations. In fiscal year 1979, SBA and FmHA loaned \$4.2 billion to individuals, businesses, and farmers for disaster-related damages.

FEMA, through FIA, also provides flood insurance to property owners in designated flood-prone areas. This program is called the National Flood Insurance Program. To participate in this federally subsidized program, communities must adopt and enforce flood plain management regulations designed to reduce the probability and severity of flood damage.

In addition, FIA administers a Federal crime insurance program to provide burglary and robbery insurance in States where the private insurance industry does not make it available or, if it does, the cost is prohibitive. FIA has responsibility for monitoring the Fair Access to Insurance Requirements plans created by the various States under the Urban Property and Reinsurance Act of 1968. These plans were created to provide property insurance to property owners in urban core areas where the shortage of insurance was increasing the "decay" of these areas.

Emergency/disaster-related activities are recognized to occur in four phases that are related by time and function to all types of disasters. These phases are mitigation, preparedness, response, and recovery. Mitigation includes any activity that actually eliminates or reduces the probability of an occurrence of a disaster, such as exercising control over the transportation of hazardous waste or long-term activities designed to reduce the effects of unavoidable disasters, such as land-use management in flood prone areas. Preparedness activities such as the development of emergency plans and the completion of training exercises are needed to the extent that mitigation measures have not prevented or cannot prevent disasters. Response activities follow an emergency or disaster and are generally emergency-type assistance for casualties, such as search and rescue, mass feeding, emergency shelters, and medical care. Recovery activities are those related to longer term steps to return a disaster area to normal, such as temporary housing and redevelopment loans.

OBJECTIVES

We are concerned with minimizing the adverse effects on communities of natural disasters--hurricanes, floods, and fires--and certain man-made disasters such as hazardous material spills. The Federal role in dealing with such catastrophes is intended to supplement the efforts and resources of States, local governments, and disaster relief organizations.

Our objectives are to report on ways the Federal Government can

--reduce the adverse effects of catastrophes on local communities,

- improve effectiveness of Federal disaster assistance provided to State and local communities,
- improve the Federal emergency management organizational structure, and
- minimize Federal disaster assistance expenditures.

PRIORITY LINE OF EFFORT

How Effective Are Federal Programs in Assisting Communities to Respond to and Recover from Catastrophes?

When a disaster occurs, local governments are responsible for taking immediate steps to warn and evacuate citizens, alleviate suffering, and protect life and property. If additional help is needed, the Governor may, under State law, declare the area a disaster area and direct execution of the State's emergency plan, committing various State resources as the situation demands.

Federal disaster relief programs are designed to supplement the efforts and available resources of State and local governments when a disaster situation is beyond their capabilities. In such situations, the Governor must request the President to declare a "major disaster" or an "emergency" under the Disaster Relief Act of 1974. As defined by the act, a major disaster is any hurricane, tornado, storm, etc., which, in the determination of the President, causes damage of sufficient severity and magnitude to warrant major disaster assistance above and beyond emergency services of the Federal Government. An emergency declaration may be made by the President for the same types of disasters but requires Federal emergency assistance to only supplement State and local efforts to save lives and protect property, public health and safety, or to avert or lessen the threat of a disaster.

In addition, certain Federal agencies have authority under their own legislation to declare a disaster area and provide disaster assistance in that area. For example, the SBA Administrator and the Secretary of Agriculture can make declarations and provide disaster loans to eligible individuals, businesses, and farmers in the declared areas.

Members of Congress and State officials have expressed concern over how the President and the Federal Emergency Management Agency determine that an area is or is not in need of assistance. Also of concern is whether the criteria FEMA and other Federal agencies use to declare an area eligible for Federal disaster assistance are similar and are consistently applied.

Substantial amounts of Federal funds (grants and loans) are provided to individuals, businesses, and farmers to assist them in recovering from disasters. Over the past 2 years, we have reviewed, based on congressional requests, various disaster assistance programs for individuals and farmers. In one review of assistance to individuals in a major disaster declared in Massachusetts in 1978, we found that many erroneous, duplicative, and unnecessary loans and grants were made to individuals as the result of poor coordination between assistance programs, lack of effective controls and enforcement procedures, and a lack of adequate review of a victim's private insurance coverage.

The lack of adequate coordination and controls has also been reported by us in a number of previous reviews. In a review of Federal assistance provided to victims of the Johnstown flood of 1977, we noted that a single interagency application form could be developed that might assist agencies in avoiding duplication of benefits. FEMA is currently testing a new single application system that should improve coordination and assist Federal agencies in avoiding duplication of benefits.

Although SBA makes more disaster loans to individuals than to businesses, businesses generally receive much larger loan amounts. In the Massachusetts disaster of 1978, 1,870 businesses received \$60 million in loans, whereas 120,000 individuals received \$65 million.

Businesses in a declared area are eligible for two types of loans--one to replace physically damaged facilities or goods and the other for economic injury. Economic injury loans are only authorized for small businesses that suffer a substantial economic loss as the result of a disaster--for example, loss of sales.

Based on our experience that erroneous and unnecessary loans were made to individuals, we believe loans to businesses should be evaluated to determine, among other things,

--if loan amounts represent actual losses and

--if businesses used loan proceeds to replace or repair items claimed in their loan applications.

A significant portion of FEMA's assistance is provided to States and local communities for their recovery after a disaster. For example, for disasters declared in fiscal year 1979, FEMA estimated that grant funds to States and local communities will total \$229 million. Public assistance includes emergency assistance (i.e., search and rescue, demolition of unsafe buildings, and emergency repairs to essential utilities); debris and wreckage clearance; permanent restoration of damaged facilities (public or private nonprofit); and community disaster loans.

We should evaluate the effectiveness of the disaster assistance provided to State and local governments and the adequacy of the grant and loan activities of FEMA.

Our objective is to provide answers to the following questions:

1. Are Federal disaster assistance programs adequately coordinated?
2. How effectively are disaster funds being targeted to the most needy?
3. How can the timeliness of disaster assistance be improved?
4. How can Federal disaster costs be reduced?

Our strategy is to improve the timing and coordination of agency disaster assistance efforts, to encourage agencies to target funds to the most needy, and to reduce program costs. We expect our actions to result in a more coordinated and cost-effective disaster assistance effort.

Ongoing assignments--August 1980

- Survey of emergency declarations by governmental institutions for natural disasters (CED 068104) (addresses questions 2 and 3).
- Review of the adequacy of coordination between Federal disaster assistance programs to ensure propriety of assistance (CED 068060) (addresses questions 1, 2, 3, and 4).

NONPRIORITY LINE OF EFFORT

How Effective Are FEMA's Programs in Minimizing the Adverse Effects of Catastrophes?

FEMA administers a number of programs and activities designed to provide assistance in State and local areas to minimize the adverse effects of catastrophes. FEMA activities that we have not reviewed recently include:

- U.S. Fire Administration activities for improving local fire protection and control.
- Crime insurance, riot reinsurance, and Fair Access to Insurance Requirements programs which need reauthorizing legislation in September 1981.

The crime insurance, Fair Access to Insurance Requirements, and riot reinsurance programs were established as a reaction to the riots of 1968. For the riot reinsurance program, only a limited number of claims have been filed since its creation, due obviously to a lack of further riots in our Nation's cities. Premiums collected by FIA on the reinsurance coverage have resulted in a growing fund balance, estimated to be \$118 million at the end of 1979. The fund balance has continued to grow despite FIA's reduced premium rates.

NONPRIORITY LINE OF EFFORT

Is the Federal Government Properly Organized to Deal Effectively with Catastrophes?

FEMA is an amalgamation of a number of Federal agencies and functions from various departments. In transferring these agencies and functions, all of the then-existing authorities and responsibilities were also transferred. However, neither the reorganization study group nor the Congress reviewed these authorities or responsibilities to determine if any changes were needed.

The Office of Technology Assessment presented the Congress with criteria for evaluating the President's Reorganization Plan. During their testimony on the plan, officials agreed that the changes were an appropriate step in the right direction, but were somewhat critical of the fact that the plan did not go far enough in making needed changes.

Many other Federal programs administered by other Federal agencies impact upon the emergency preparedness activities of FEMA, affecting one or more of the four phases of emergency preparedness. For example, the Army Corps of Engineers builds dams and other flood control projects. These are Federal mitigation activities to reduce the effects of flooding. Should FEMA have some authority over these projects? Is FEMA adequately coordinating its activities with these programs? We believe that this and similar relationships with other Federal agencies warrant our attention from the standpoint of determining whether FEMA has adequate responsibility and authority to assure that the Federal Government's emergency management activities are as efficient and well coordinated as possible.

In organizing FEMA, the Director has integrated the Federal Disaster Assistance Administration, the Defense Civil Preparedness Agency, and the Federal Preparedness Agency into three new offices:

- Plans and Preparedness.
- Disaster Response and Recovery.
- Mitigation and Research.

These are basically in line with the four phases of emergency preparedness. However, the Federal Insurance Administration and the U.S. Fire Administration have been generally left intact.

Some of the activities of these two agencies relate to the four phases of emergency preparedness, and questions exist as to whether these activities are properly located within FEMA. For example, FIA and the U.S. Fire Administration both have research responsibilities which might more appropriately be performed by FEMA's Mitigation and Research Office.

Ongoing assignments-August 1980

None

OUR AUDIT REPORTS

Federal Response to 76-77 Drought: What Should Be Done Next? (CED-79-26, 1/31/79).

Efforts To Reduce Flood Losses: Flood Insurance Program (CED-79-58, 3/22/79).

Examination of Financial Statements of the National Flood Insurance Program as of December 31, 1977 (CED-79-70, 6/1/79).

Action Needed To Improve the Review of Insurance Coverage of Disaster Victims Receiving Federal Assistance (CED-79-90, 6/18/79).

Federal Snow Removal Reimbursement Policy: Improvements Needed (CED-79-97, 8/2/79).

Farmers Home Administration and Small Business Administration Natural Disaster Loan Programs: Budget Implications and Beneficiaries (CED-79-111, 8/6/79).

How Do Federal Agencies Assure That Disaster Loan Recipients Maintain Mandatory Flood Insurance? (CED-80-10, 10/26/79).

Review of Federal Disaster Assistance to Two Libraries in Pennsylvania (CED-80-22, 10/31/79).

Improvements Being Made in Flood Fighting Capabilities in the Jackson, Mississippi, Area (CED-80-36, 12/18/79).

Farmers Home Administration Emergency Loan Processing Procedures in Stanislaus County, California (CED-80-64, 3/3/80).

States Can Be Better Prepared To Respond to
Disasters (CED-80-60, 3/31/80).

Federal Disaster Assistance Policy: What
Should the Policy Be? (PAD-80-39, 6/16/80).

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